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Part 1

July 9, 1975

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

Prepared for the Federal Open Market Committee
By the staff of the Board of Governors of the Federal Reserve System

CONFIDENTIAL (FR)

July 9, 1975

SUMMARY AND OUTLOOK

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

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. The beginnings of recovery are now evident in several key sectors of the economy. Although a substantial rate of inventory liquidation apparently kept the second quarter from showing over-all real growth, prospects for an upturn in the third quarter have strengthened. As yet, however, no major sector has displayed signs of unusual vigor, and we therefore still expect a comparatively moderate recovery over the next year.

Industrial production seems to have stabilized in June and may have shown its first increase after 8 months of steady decline. Output of both durable and nondurable consumer goods apparently increased last month, but production of business equipment and materials continued to fall. Auto assemblies rose by 9 per cent, and the recent sales rise suggests that industry schedules for further expansion in auto production during the third quarter will be maintained.

The continued increase in unit sales of domestic auto models during the last 10 days of June brought the total for the month to a 7.1 million annual rate, up from 6.2 million in May and 5.7 million in April. Sales of foreign models were at a 1.6 million annual rate in June, holding at about this rate since March. The level of auto sales remains comparatively low, but the recent improvement in domestic car sales was somewhat better than we had been projecting.

Excluding autos, retail sales were about unchanged in June-- judging by weekly data--following an unusually strong May rise. The figures for the second quarter as a whole, however, indicate a rise in real consumer purchases of goods, particularly for such "non-essential" categories as food away from home, furniture and appliances, and apparel. Sales in the GAF category of stores were up about 4-1/2 per cent in the second quarter, not at an annual rate.

The outlook for consumer expenditures has continued to improve according to the Michigan survey taken in May. Consumers were much less pessimistic than in February and more thought it was a good time to purchase household durables, autos, and houses. The level of the index of consumer sentiment, however, is still quite depressed.

The long-awaited upturn in residential construction activity now seems firmly underway. Private housing starts increased in May by 14 per cent to a 1.1 million unit annual rate. The rise occurred among both single and multifamily units and was widespread geographically. Residential building permits also rose in May-- by 9 per cent--to a level about a third above their low this past March. Further gains in activity from present low levels seem likely, given the improved supply of mortgage credit, the recent strong rise in sales and the associated reduction in unsold units, as well as the prospect of increased Federal support due to the revised housing bill.

Business outlays for fixed capital in real terms are still declining and any appreciable recovery in this sector does not appear likely in the near term. Orders for nondefense capital goods rose by 1 per cent further in May following a strong April surge, but the level of these orders remains about a fifth below their mid-1974 high. Moreover, contracts for commercial and industrial buildings (square feet) fell sharply in May, retracing much of the large April gain.

New orders for durable goods as a whole also rose by 1 per cent in May following a 9 per cent increase the preceding month. Further increases in these orders are likely in the months ahead as adjustments in inventories are completed in larger numbers of industries. In May, inventory liquidation was still in full swing in manufacturing. The book value of manufacturers' inventories declined by \$17 billion annual rate, following a \$12 billion drop in April. Both durable and nondurable stocks declined sharply; in non-durables, this development occurred despite a sizable earlier reduction in the inventory/shipments ratio in this sector. The May decline in materials stocks could well be associated with the large reduction of materials imports that month.

The labor market appears to have stabilized in the past few months--with layoffs down and some recovery underway in hiring. As was well publicized, the decline in the unemployment rate in

June represented problems of seasonal adjustment connected with handling the influx of younger workers into the labor market at the end of the school year; the unemployment rate remained about unchanged for adults. Total nonfarm payroll employment--and factory jobs--were about unchanged in June.

Both wages and prices have been rising at a moderate pace recently. The average hourly earnings index jumped in June, but the rate of increase has been moderating steadily over the past three quarters. In the second quarter, the index increased at a 6.6 per cent annual rate. Developments in wholesale prices also have been favorable, with the index down 0.1 per cent, seasonally adjusted, in June--as lower prices for farm products and foods more than offset a rise in industrials. The larger increase for industrials was due mainly to higher prices for petroleum and products. Consumer prices rose by 0.4 per cent in May, with a marked slowing evident among nonfood commodities and services.

Outlook. The current staff GNP projection conforms in major outline to the projections shown in the preceding Greenbook. However, the projected growth of real GNP has been raised slightly to an average of about 5-3/4 per cent over the next six quarters. Projected price levels have also been raised somewhat, due to larger recent increases in prices of petroleum products than previously allowed for.

Our assumptions of future fiscal and energy developments remain virtually unchanged. The unified budget deficit is expected to be \$69 billion in FY 1976, close to the Congressional figure. On the energy side, we still assume only a small further increase in crude oil prices, due to an October 1st OPEC increase of \$1 per barrel in the price of crude. There is a real possibility of a gradual decontrol in the price of old oil, instead of the extension on controls that we have assumed. But at the moment the uncertainties in this area appear too great to incorporate a specific change in assumptions.

On the monetary side, we assume a rate of growth in M_1 averaging around 6-1/4 per cent over the projection period. Short-term interest rates are assumed to continue moving up--with the bill rate rising to 7-1/2 per cent by late this year and approaching 8-3/4 per cent in late 1976.

The more rapid growth in real GNP now expected in the second half of this year--about 6 per cent, annual rate--reflects in large measure a more vigorous rebound in inventories following the sharper-than-anticipated second quarter liquidation. In addition, the higher rate of auto sales recently is anticipated to carry over into early fall, partially in response to announced price increases for 1976 models. On the other hand, net exports are projected to weaken substantially, as imports rebound from their unusually low level in the second quarter.

During 1976, the projected real growth rate of GNP stays in a narrow range of 5.5 to 5.8 per cent. While the upward thrust on GNP from inventory rebuilding and residential construction fades as the year progresses, growth is nevertheless fairly well maintained as business fixed investment strengthens in real terms.

Reflecting in part the slightly higher projected level of economic activity, and in part recent labor market developments, the projected unemployment rate has been reduced by between 0.2 and 0.3 percentage points during the next six quarters. The rate is now expected to average 9.0 per cent in the third quarter of 1975 and to decline to 8.2 per cent by the fourth quarter of 1976.

Price projections have been raised somewhat for the third quarter of 1975, but the rates of change thereafter remain unchanged from the previous projection. The greater third quarter increase--which temporarily interrupts the steady moderation projected for price increases--is directly related to the recently-announced price hikes in gasoline and other petroleum products, which have been larger than we had expected. The increase in the gross private product fixed weighted price index is still expected to moderate during 1976, averaging about 4-1/2 per cent annual rate toward the end of next year.

STAFF GNP PROJECTIONS

	Changes in nominal GNP (\$ billions)		Per cent change, annual rate					
			Real GNP		Gross private product fixed weighted price index		Unemployment rate (per cent)	
					6/11/75	7/9/75		
	6/11/75	7/9/75	6/11/75	7/9/75	6/11/75	7/9/75	6/11/75	7/9/75
1972 <u>I</u> /	103.1	103.1	6.2	6.2	3.3	3.3	5.6	5.6
1973 <u>I</u> /	136.9	136.9	5.9	5.9	6.3	6.3	4.9	4.9
1974 <u>I</u> /	102.5	102.5	-2.1	-2.1	11.4	11.4	5.6	5.6
1975	71.4	70.5	-4.0	-3.9	9.3	9.3	8.9	8.4
1976	163.5	167.5	5.2	5.4	5.4	5.4	8.7	8.5
1974-I <u>I</u> /	14.8	14.8	-7.0	-7.0	14.1	14.1	5.2	5.2
II <u>I</u> /	25.0	25.0	-1.6	-1.6	12.3	12.3	5.1	5.1
III <u>I</u> /	32.5	32.5	-1.9	-1.9	13.8	13.8	5.5	5.5
IV <u>I</u> /	14.6	14.6	-9.0	-9.0	12.6	12.6	6.6	6.6
1975-I <u>I</u> /	-13.8	-14.3	-11.3	-11.4	7.7	7.7	8.3	8.3
II	25.9	22.4	.3	.0	7.0	6.3	9.2	8.9
III	42.0	46.0	5.4	6.1	6.3	6.8	9.2	9.0
IV	45.0	46.0	5.7	6.0	5.6	5.5	9.0	8.8
1976-I	41.5	42.0	5.6	5.8	5.3	5.2	8.9	8.7
II	40.0	41.5	5.4	5.8	4.9	4.9	8.8	8.5
III	40.0	40.5	5.4	5.5	4.7	4.7	8.6	8.3
IV	43.0	44.0	5.3	5.5	4.6	4.6	8.5	8.2
Change:								
74-II to 75-II	59.2	55.2	-5.6	-5.7	10.2	10.1	4.1	3.8
74-IV to 75-IV	99.1	100.1	- .3	- .1	6.6	6.6	2.4	2.2
75-II to 76-II	168.5	175.5	5.5	5.9	5.5	5.6	- .4	- .4
75-IV to 76-IV	164.5	168.0	5.4	5.6	4.9	4.9	- .5	- .6

I/ Actual.

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

	1975				Projected	1976			
	I	II	III	IV		I	II	III	IV
Gross National Product	1416.6	1439.0	1485.0	1531.0	1573.0	1614.5	1655.0	1699.0	
Final purchases	1435.8	1458.0	1495.3	1533.0	1567.0	1604.0	1642.5	1684.5	
Private	1104.2	1120.1	1150.4	1176.9	1203.0	1232.4	1263.3	1294.0	
Excluding net exports	1095.4	1112.8	1147.3	1178.5	1207.3	1238.8	1269.7	1300.7	
Personal consumption expenditures	913.2	934.3	964.1	988.9	1010.5	1033.1	1056.3	1079.9	
Durable goods	124.9	127.8	132.3	136.6	140.6	144.3	148.3	152.3	
Nondurable goods	398.8	408.0	422.3	431.6	438.0	445.7	453.7	462.1	
Services	389.5	398.5	409.5	420.7	431.9	443.1	454.3	465.5	
Gross private domestic investment	163.1	159.5	172.9	187.6	202.8	216.2	225.9	235.3	
Residential construction	35.3	34.7	39.2	43.6	47.6	52.5	55.7	57.1	
Business fixed investment	146.9	143.8	144.0	146.0	149.2	153.2	157.7	163.7	
Change in business inventories	-19.2	-19.0	-10.3	-2.0	6.0	10.5	12.5	14.5	
Nonfarm	-17.8	-18.0	-10.0	-3.0	6.0	10.5	12.5	14.5	
Net exports of goods and services ^{1/}	8.8	7.3	3.1	-1.6	-4.3	-6.4	-6.4	-6.7	
Exports	142.2	132.1	134.0	138.1	143.1	147.9	153.3	158.5	
Imports	133.4	124.8	130.9	139.7	147.4	154.3	159.7	165.2	
Gov't. purchases of goods and services	331.6	337.9	344.9	356.1	364.0	371.6	379.2	390.5	
Federal	126.5	128.4	130.1	135.3	137.2	138.6	140.3	146.1	
Defense	84.7	85.6	86.1	90.3	91.2	92.2	93.1	97.1	
Other	41.8	42.8	44.0	45.0	46.0	46.4	47.2	49.0	
State and local	205.1	209.5	214.8	220.8	226.8	233.0	238.9	244.4	
Gross national product in constant (1958) dollars	780.0	780.1	791.8	803.4	814.8	826.4	837.4	848.7	
GNP implicit deflator (1958=100)	181.6	184.5	187.6	190.6	193.0	195.4	197.6	200.2	
Personal income	1193.4	1220.3	1247.9	1280.7	1309.0	1341.2	1373.1	1406.1	
Wage and salary disbursements	765.1	773.7	792.2	814.5	835.0	856.0	876.0	899.3	
Disposable income	1015.5	1079.3	1073.1	1098.0	1118.4	1145.0	1169.9	1196.8	
Personal saving	75.9	119.1	82.8	82.6	80.9	84.6	85.8	88.7	
Saving rate (per cent)	7.5	11.0	7.7	7.5	7.2	7.4	7.3	7.4	
Corporate profits & inventory val. adj.	94.3	98.4	110.2	119.6	126.1	133.3	140.3	147.8	
Corporate profits before tax	101.2	103.0	118.0	128.5	134.0	140.0	146.0	153.0	
Federal government receipts and expenditures, (N.I.A. basis)									
Receipts ^{2/}	284.1	248.0	291.0	303.2	317.8	326.8	336.9	346.8	
Expenditures	338.5	355.4	361.7	372.4	379.4	387.5	395.4	407.0	
Surplus or deficit (-) ^{2/}	-54.4	-107.4	-70.7	-69.2	-61.6	-60.7	-58.5	-60.2	
High employment surplus or deficit (-)	9.6	-37.0	-8.5	-10.1	-5.4	-5.7	-4.2	-7.0	
State and local government surplus or deficit (-) (N I.A. basis)	-1.6	-2.5	-2.1	-1.1	-1.0	-1.9	-3.2	-2.5	
Total labor force (millions)	94.0	94.7	95.2	95.4	95.8	96.2	96.5	96.9	
Armed forces "	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	
Civilian labor force "	91.8	92.5	92.9	93.1	93.4	93.8	94.2	94.6	
Unemployment rate (per cent)	8.3	8.9	9.0	8.8	8.7	8.5	8.3	8.2	
Nonfarm payroll employment (millions)	76.8	76.4	76.8	77.2	77.6	78.1	78.6	79.1	
Manufacturing	18.4	18.1	18.2	18.3	18.5	18.7	19.0	19.2	
Industrial production (1967 = 100)	111.6	109.4	112.1	115.3	118.7	121.5	124.2	126.9	
Capacity utilization, mfg. (per cent)	68.2	66.3	67.4	68.8	70.3	71.4	72.4	73.4	
Major materials (per cent)	70.2	70.3	72.9	75.6	77.9	79.7	81.0	82.3	
Housing starts, private (millions, A.R.)	.99	1.10	1.33	1.50	1.60	1.65	1.70	1.70	
Sales new autos (millions, A.R.)	8.31	7.90	8.60	9.10	9.65	9.69	9.98	10.50	
Domestic models	6.60	6.33	7.00	7.50	8.00	8.00	8.25	8.75	
Foreign models	1.71	1.57	1.60	1.60	1.65	1.69	1.73	1.75	
^{1/} Net exports of g. & s. (Bal. of paym'ts)	13.4 ^{2/}	11.8 ^{2/}	7.6 ^{2/}	2.9 ^{2/}	.2	-1.9	-1.9	-2.2	
Exports	148.6 ^{3/}	138.5 ^{3/}	140.4 ^{3/}	144.5 ^{3/}	149.5	154.3	159.7	164.9	
Imports	135.3	126.7	132.8	141.6	149.3	156.2	161.6	167.1	

^{2/} Federal government N.I.A. receipts in 1975-II reflect the \$8.1 billion rebate of 1974 individual income taxes and in 1975-III and following quarters the \$9.3 billion reduction in 1975 individual income taxes; this latter reduction, enacted only for 1975, is assumed to be continued in 1976.

^{3/} Includes \$.3 billion, annual rate of shipments of military equipment and supplies to Israel which are not included in GNP exports.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	I	1975			Projected		1976	
		II	III	IV	I	II	III	IV
Gross National Product	-14.3	22.4	46.0	46.0	42.0	41.5	40.5	44.0
Inventory changes	-37.0	.2	8.7	8.3	8.0	4.5	2.0	2.0
Final purchases	22.7	22.2	37.3	37.7	34.0	37.0	38.5	42.0
Private	14.9	15.9	30.3	26.5	26.1	29.4	30.9	30.7
Net exports	6.9	-1.5	-4.2	4.7	-2.7	-2.1	.0	-.3
Excluding net exports	8.0	17.4	34.5	31.2	28.8	31.5	30.9	31.0
Personal consumption expenditures	17.4	21.1	29.8	24.8	21.6	22.6	23.2	23.6
Durable goods	4.2	2.9	4.5	4.3	4.0	3.7	4.0	4.0
Nondurable goods	7.1	9.2	14.3	9.3	6.4	7.7	8.0	8.4
Services	6.0	9.0	11.0	11.2	11.2	11.2	11.2	11.2
Residential fixed investment	-5.1	-.6	4.5	4.4	4.0	4.9	3.2	1.4
Business fixed investment	-4.3	-3.1	.2	2.0	3.2	4.0	4.5	6.0
Government	7.8	6.3	7.0	11.2	7.9	7.6	7.6	11.3
Federal	2.0	1.9	1.7	5.2	1.9	1.4	1.7	5.8
State and local	5.8	4.4	5.3	6.0	6.2	6.0	5.9	5.5
GNP in constant (1958) dollars	-24.0	.1	11.7	11.6	11.4	11.6	11.0	11.3
Final purchases	-1.3	.2	8.1	5.2	5.1	8.6	10.3	9.6
Private	-2.7	-1.0	7.3	7.4	7.0	8.3	9.9	9.4
		-----In Per Cent Per Year----- ^{1/}						
Gross National Product	-3.9	6.5	13.4	13.0	11.4	11.0	10.4	11.1
Final purchases	6.6	6.3	10.6	10.5	9.2	9.8	10.0	10.6
Private	5.6	5.9	11.3	9.5	9.2	10.1	10.4	10.1
Personal consumption expenditures	8.0	9.6	13.4	10.7	9.0	9.3	9.3	9.2
Durable goods	14.7	9.6	14.8	13.6	12.2	10.9	11.6	11.2
Nondurable goods	7.5	9.6	14.8	9.1	6.1	7.2	7.4	7.6
Services	6.4	9.6	11.5	11.4	11.1	10.8	10.5	10.2
Gross private domestic investment	-63.2	-8.5	38.1	38.6	36.6	29.2	19.2	17.7
Residential structures	-41.7	-6.6	62.9	53.0	42.1	48.0	26.7	10.4
Business fixed investment	-10.9	-8.2	.6	5.7	9.1	11.2	12.3	16.1
Gov't purchases of goods & services	10.0	7.8	8.5	13.6	9.2	8.6	8.4	12.5
Federal	6.6	6.1	5.4	17.0	5.7	4.1	5.0	17.6
Defense	3.4	4.3	2.4	21.0	4.0	4.5	4.0	18.3
Other	12.4	9.9	11.7	9.4	9.2	3.5	7.1	16.1
State and local	12.2	8.9	10.5	11.7	11.3	11.4	10.5	9.5
GNP in constant (1958) dollars	-11.4	.0	6.1	6.0	5.8	5.8	5.5	5.5
Final purchases	-.7	.1	4.2	2.7	2.5	4.3	5.1	4.8
Private	-1.7	-.6	4.6	4.6 ^{2/}	4.4 ^{2/}	5.1	6.0	5.6 ^{2/}
GNP implicit deflator	8.4 ^{2/}	6.4	6.9	6.6 ^{2/}	5.3 ^{2/}	4.9	4.7	5.3 ^{2/}
Private GNP fixed weighted index ^{3/}	7.7	6.3	6.8	5.5	5.2	4.9	4.7	4.6
Personal income	2.2	9.3	9.4	10.9	9.1	10.2	9.9	10.0
Wage and salary disbursements	-2.1	4.6	9.9	11.7	10.5	10.4	9.7	11.1
Disposable income	2.7	27.6	-2.3	9.6	7.6	9.9	9.0	9.5
Corporate profits before tax	-64.9	7.3	72.3	40.6	18.3	19.1	18.3	20.6
Federal Government receipts and expenditures (N.I.A. basis)								
Receipts	-13.6	-41.9	89.6	17.9	20.7	11.8	12.9	12.3
Expenditures	26.3	21.5	7.3	12.4	7.7	8.8	8.4	12.3
Nonfarm payroll employment	-7.7	-1.8	2.0	2.1	2.1	2.6	2.6	2.6
Manufacturing	-22.3	-6.1	2.2	2.2	4.4	4.4	6.6	4.3
Industrial production	-28.4	-7.5	10.1	11.9	12.3	9.8	9.2	9.0
Housing starts, private	-2.4	52.4	113.7	61.8	29.4	13.1	12.7	.0
Sales new autos	60.9	-18.3	40.4	25.4	26.5	1.7	12.5	22.5
Domestic models	41.8	-15.4	49.5	31.8	29.5	.0	13.1	25.5
Foreign models	172.4	-28.9	7.9	.0	13.1	10.1	9.8	4.7

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

^{2/} Excluding Federal pay increases rates of change are: 1975-I, 8.3 per cent; 1975-IV, 5.5 per cent; 1976-I, 5.2 per cent; and 1976-IV, 4.6 per cent.

^{3/} Using expenditures in 1967 as weights.

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

	1973				1974			
	I	II	III	IV	I	II	III	IV
Gross National Product	1248.9	1277.9	1308.9	1344.0	1358.8	1383.8	1416.3	1430.9
Final purchases	1238.9	1267.2	1297.0	1315.1	1341.9	1370.3	1407.6	1413.1
Private	969.9	993.9	1020.1	1028.7	1045.6	1065.9	1095.3	1089.3
Excluding net exports	970.7	993.4	1013.4	1019.4	1034.3	1067.4	1098.4	1087.4
Personal consumption expenditures	781.7	799.0	816.3	823.9	840.6	869.1	901.3	895.8
Durable goods	132.4	132.1	132.4	124.3	123.9	129.5	136.1	120.7
Nondurable goods	323.3	332.7	343.8	352.1	364.4	375.8	389.0	391.7
Services	325.9	334.2	340.1	347.4	352.4	363.8	376.2	383.5
Gross private domestic investment	199.0	205.1	209.0	224.5	210.5	211.8	205.8	209.4
Residential construction	58.5	58.7	58.1	53.6	48.4	48.8	46.2	40.4
Business fixed investment	130.5	135.6	139.0	141.9	145.2	149.4	150.9	151.2
Change in business inventories	10.0	10.7	11.8	28.9	16.9	13.5	8.7	17.8
Nonfarm	6.5	7.7	7.4	24.0	13.1	10.4	6.6	17.5
Net exports of goods and services ^{1/}	-.8	.5	6.7	9.3	11.3	-1.5	-3.1	1.9
Exports	88.8	95.4	103.7	113.6	131.2	138.5	143.6	147.5
Imports	89.5	94.9	96.9	104.3	119.9	140.0	146.7	145.7
Gov't. purchases of goods and services	269.0	273.3	276.9	286.4	296.3	304.4	312.3	323.8
Federal	106.4	106.2	105.3	108.4	111.5	114.3	117.2	124.5
Defense	75.0	74.0	73.3	75.3	75.8	76.6	78.4	84.0
Other	31.4	32.2	32.0	33.1	35.7	37.7	38.8	40.6
State & local	162.6	167.1	171.6	177.9	184.8	190.1	195.1	199.3
Gross national product in constant (1958) dollars	832.8	837.4	840.8	845.7	830.5	827.1	823.1	804.0
GNP implicit deflator (1958 = 100)	150.0	152.6	155.7	158.9	163.6	167.3	172.1	178.0
Personal income	1013.6	1039.2	1068.0	1099.3	1112.5	1134.6	1168.2	1186.9
Wage and salary disbursements	667.6	683.8	698.2	717.0	727.6	745.2	763.0	769.2
Disposable income	869.5	892.1	913.9	939.4	950.6	966.5	993.1	1008.8
Personal saving	65.3	69.6	73.2	89.3	84.4	71.5	65.5	86.5
Saving rate (per cent)	7.5	7.8	8.0	9.5	8.9	7.4	6.6	8.6
Corporate profits & inventory val. adj.	103.9	105.0	105.2	106.4	107.7	105.6	105.8	103.4
Corporate profits before tax	120.4	124.9	122.7	122.7	135.4	139.0	157.0	131.5
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	249.1	255.0	261.8	268.3	278.1	288.6	302.8	294.7
Expenditures	260.2	262.4	263.4	270.6	281.0	291.6	304.7	319.3
Surplus or deficit (-)	-11.2	-7.4	-1.7	-2.3	-2.8	-3.0	-1.9	-24.5
High employment surplus or deficit (-)	-8.5	-3.4	4.6	4.8	14.0	19.6	24.7	17.8
State and local government surplus or deficit (-), (N.I.A. basis)	13.2	10.4	8.4	4.6	3.2	2.0	2.1	-.1
Total labor force (millions)	90.0	90.8	91.3	92.1	92.7	92.9	93.6	94.0
Armed forces "	2.4	2.3	2.3	2.3	2.3	2.2	2.2	2.2
Civilian labor force "	87.6	88.5	89.0	89.8	90.5	90.6	91.4	91.8
Unemployment rate (per cent)	5.0	4.9	4.8	4.8	5.2	5.1	5.5	6.6
Nonfarm payroll employment (millions)	75.8	76.5	77.1	77.8	78.0	78.3	78.7	78.3
Manufacturing	19.8	20.0	20.1	20.3	20.2	20.2	20.1	19.6
Industrial production (1967 = 100)	123.1	124.8	126.7	127.0	124.9	125.5	125.4	121.3
Capacity utilization, mfg. (per cent)	82.8	83.3	83.3	82.6	80.5	80.1	79.4	75.7
Major materials (per cent)	93.0	93.4	93.5	92.3	90.2	90.2	88.5	79.1
Housing starts, private (millions, A.R.)	2.39	2.17	2.01	1.62	1.61	1.53	1.21	1.00
Sales new autos (millions, A.R.)	12.18	12.03	11.33	10.15	9.04	9.17	10.07	7.38
Domestic models	10.26	10.17	9.66	8.51	7.49	7.92	8.52	6.05
Foreign models	1.92	1.85	1.67	1.64	1.55	1.25	1.55	1.33
^{1/} Net exports of g. & s. (Bal. of Paymts.)	-.7	.5	6.6	10.9 ^{2/}	11.2 ^{2/}	-.7 ^{2/}	-1.3 ^{2/}	3.3 ^{2/}
Exports	88.8	95.4	103.7	116.0 ^{2/}	132.3 ^{2/}	140.2 ^{2/}	146.8 ^{2/}	151.1 ^{2/}
Imports	89.5	94.9	97.1	105.1	121.1	140.9	148.1	147.8

^{2/} Includes shipments of military equipment and supplies to Israel which are not included in GNP exports; amounts in billions of dollars at annual rates are 1973-IV, \$2.4; 1974-I, \$.3; 1974-II, \$.4, 1974-III, \$.3; and 1974-IV, \$.3.

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CONFIDENTIAL - FRCHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1973				1974			
	I	II	III	IV	I	II	III	IV
	-----Billions of Dollars-----							
Gross National Product	44.2	29.0	31.0	35.1	14.8	25.0	32.5	14.6
Inventory change	-1.0	.7	1.1	17.1	-12.0	-3.4	-4.8	9.1
Final purchases	45.2	28.3	29.8	18.1	26.8	28.4	37.3	5.5
Private	38.8	24.0	26.2	8.6	16.9	20.3	29.4	-6.0
Net exports	4.5	1.3	6.2	2.6	2.0	-12.8	-1.6	5.0
Excluding net exports	34.3	22.7	20.0	6.0	14.9	33.1	31.0	-11.0
Personal consumption expenditures	24.5	17.3	17.3	7.6	16.7	28.5	32.2	-5.5
Durable goods	8.1	-.3	.3	-8.1	-.4	5.6	6.6	-15.4
Nondurable goods	12.4	9.4	11.1	8.3	12.3	11.4	13.2	2.7
Services	3.9	8.3	5.9	7.3	5.0	11.4	12.4	7.3
Residential fixed investment	1.8	.2	-.6	-4.5	-5.2	.4	-2.6	-5.8
Business fixed investment	8.0	5.1	3.4	2.9	3.3	4.2	1.5	.3
Government	6.4	4.3	3.6	9.5	9.9	8.1	7.9	11.5
Federal	1.2	-.2	-.9	3.1	3.1	2.8	2.9	7.3
State and local	5.2	4.5	4.5	6.3	6.9	5.3	5.0	4.2
GNP in constant (1958) dollars	18.6	4.6	3.4	4.9	-15.2	-3.4	-4.0	-19.1
Final purchases	20.2	4.1	3.1	-7.0	-5.8	-1.0	-.8	-25.0
Private	19.1	4.3	3.3	-9.0	-6.1	-.8	-.9	-25.4
	-----In Per Cent Per Year ^{1/} -----							
Gross National Product	15.5	9.6	10.1	11.2	4.5	7.6	9.7	4.2
Final purchases	16.0	9.5	9.7	5.7	8.4	8.7	11.3	1.6
Private	17.7	10.3	11.0	3.4	6.7	8.0	11.5	-2.2
Personal consumption expenditures	13.6	9.2	8.9	3.8	8.4	14.3	15.7	-2.4
Durable goods	28.7	-.9	.9	-22.3	-1.3	19.3	22.0	-38.1
Nondurable goods	16.9	12.1	14.0	10.0	14.7	13.1	14.8	2.8
Services	4.9	10.6	7.3	8.9	5.9	13.6	14.3	8.0
Gross private domestic investment	19.8	12.8	7.8	33.1	-22.7	2.5	-10.9	7.2
Residential structures	13.3	1.4	-4.0	-27.6	-33.5	3.3	-19.7	-41.5
Business fixed investment	28.8	16.6	10.4	8.6	9.6	12.1	4.1	.8
Gov't. purchases of goods and services	10.1	6.5	5.4	14.4	14.6	11.4	10.8	15.6
Federal	4.6	-.7	-3.3	12.3	11.9	10.4	10.5	27.3
Defense	1.6	-5.2	-3.7	11.4	2.7	4.3	9.7	31.8
Other	12.3	10.6	-2.5	14.5	35.3	24.4	12.2	19.9
State and local	13.9	11.5	11.2	15.5	16.4	12.0	10.9	8.9
GNP in constant (1958) dollars	9.5	2.2	1.6	2.4	-7.0	-1.6	-1.9	-9.0
Final purchases	10.4	2.0	1.5	-3.3	-2.8	-.5	-.4	-11.7
Private	12.0	2.5	1.9	-5.1	-3.5	-.5	-.5	-14.3
GNP implicit deflator	5.5	7.3	8.3	8.6	12.3	9.4	11.9	14.4
Private GNP fixed weighted index ^{2/}	7.4	8.1	8.4	9.1	14.1	12.3	13.8	12.6
Personal income	12.1	10.5	11.6	12.2	4.9	8.2	12.4	6.6
Wage and salary disbursements	13.0	10.1	8.7	11.7	6.0	10.0	9.9	3.3
Disposable income	15.8	10.8	10.1	11.6	4.9	6.9	11.5	6.5
Corporate profits before tax	53.3	15.8	-6.9	.0	48.3	11.1	62.8	-50.8
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	25.0	9.8	11.1	10.3	15.4	16.0	21.2	-10.3
Expenditures	-1.5	3.4	1.5	11.4	16.3	16.0	19.2	20.6
Nonfarm payroll employment	5.0	3.9	3.0	3.8	1.0	1.6	1.7	-1.7
Manufacturing	6.3	4.4	2.1	3.7	-2.4	-.3	-.6	-10.4
Industrial production	10.0	5.6	6.2	1.0	-6.5	1.9	-.3	-12.5
Housing starts, private	-5.5	-32.7	-25.3	-58.3	-2.0	-19.1	-60.7	-53.0
Sales new autos	18.3	-5.0	-71.3	-35.5	-37.1	5.9	45.5	-71.7
Domestic models	15.4	-3.5	-18.6	-39.8	-40.0	25.1	33.8	-74.6
Foreign models	35.4	-12.9	-35.0	-5.9	-20.0	-57.8	138.3	-46.2

^{1/} Percentage rates are annual rates compounded quarterly.^{2/} Using expenditures in 1967 as weights.

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

	1969	1970	1971	1972	1973	1974	1975	1976
							Projected	
Gross National Product	930.3	977.1	1054.9	1158.0	1294.9	1397.4	1467.9	1635.4
Final purchases	922.5	972.6	1048.6	1149.5	1279.6	1383.2	1480.5	1624.5
Private	712.5	753.1	814.4	893.8	1003.2	1074.0	1137.9	1248.2
Excluding net exports	710.6	749.5	814.6	899.8	999.3	1071.9	1133.5	1254.1
Personal consumption expenditures	579.5	617.6	667.1	729.0	805.2	876.7	950.1	1045.0
Durable goods	90.8	91.3	103.9	118.4	130.3	127.5	130.4	146.4
Nondurable goods	245.9	263.8	278.4	299.7	338.0	380.2	415.2	449.9
Services	242.7	262.6	284.8	310.9	336.9	369.0	404.6	448.7
Gross private domestic investment	139.0	136.3	153.7	179.3	209.4	209.4	170.8	220.1
Residential Construction	32.6	31.2	42.8	54.0	57.2	46.0	38.2	53.2
Business fixed investment	98.5	100.6	104.6	116.8	136.8	149.2	145.2	156.0
Change in business inventories	7.8	4.5	6.3	8.5	15.4	14.2	-12.6	10.9
Nonfarm	7.7	4.3	4.9	7.8	11.4	11.9	-12.2	10.9
Net exports of goods and services ^{1/}	1.9	3.6	- .2	- 6.0	3.9	2.1	4.4	-6.0
Exports	55.5	62.9	65.4	72.4	100.4	140.2	136.6	150.7
Imports	53.6	59.3	65.6	78.4	96.4	138.1	132.2	156.7
Gov't. purchases of goods and services	210.0	219.5	234.2	255.7	276.4	309.2	342.6	376.3
Federal	98.8	96.2	97.6	104.9	106.6	116.9	130.1	140.6
Defense	78.4	74.6	71.2	74.8	74.4	78.7	86.7	93.4
Other	20.4	21.6	26.5	30.1	32.2	38.2	43.4	47.2
State & local	111.2	123.3	136.6	150.8	169.8	192.3	212.6	235.8
Gross national product in constant (1958) dollars	725.6	722.5	746.3	792.5	839.2	821.2	788.8	831.8
GNP implicit deflator (1958=100)	128.2	135.4	141.4	146.1	154.3	170.2	186.1	196.6
Personal income	750.9	808.3	864.0	944.9	1055.0	1150.5	1235.6	1357.4
Wage and salary disbursements	509.7	542.0	573.0	626.8	691.7	751.2	786.4	851.6
Disposable income	634.4	691.7	746.4	802.5	903.7	979.7	1066.5	1157.5
Personal saving	38.2	56.2	60.5	52.6	74.4	77.0	90.1	85.0
Saving rate (per cent)	6.0	8.1	8.1	6.6	8.2	7.9	8.4	7.3
Corporate profits & inventory val. adj.	79.8	69.2	78.7	92.2	105.1	105.6	105.6	136.9
Corporate profits before tax	84.9	74.0	83.6	99.2	122.7	140.7	112.7	143.3
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	197.3	192.0	198.5	227.2	258.5	291.1	281.6	332.1
Expenditures	189.2	203.9	220.3	244.7	264.2	299.1	357.0	392.3
Surplus or deficit (-)	8.1	-11.9	-21.9	-17.5	-5.6	-8.1	-75.4	-60.3
High employment surplus or deficit (-)	8.8	3.7	-4.7	-6.7	- .7	19.1	-11.5	-5.6
State and local government surplus or deficit (-), (N.I.A. basis)	.7	1.8	3.4	12.3	9.2	1.8	-1.8	-2.2
Total labor force (millions)	84.2	85.9	86.9	89.0	91.0	93.2	94.8	96.4
Armed forces "	3.5	3.2	2.8	2.4	2.3	2.2	2.2	2.2
Civilian labor force "	80.7	82.7	84.1	86.5	88.7	91.0	92.6	94.0
Unemployment rate (per cent)	3.5	4.9	5.9	5.6	4.9	5.6	8.8	8.5
Nonfarm payroll employment (millions)	70.4	70.9	71.2	73.7	76.8	78.3	76.8	78.4
Manufacturing	20.2	19.3	18.6	19.1	20.1	20.0	18.3	18.9
Industrial production (1967 = 100)	110.7	106.7	106.8	115.2	125.6	124.7	112.1	122.8
Capacity utilization, mfg. (per cent)	86.5	78.3	75.0	78.6	83.0	78.9	67.7	71.9
Major materials (per cent)	90.0	86.2	85.3	89.6	93.0	87.0	72.0	80.2
Housing starts, private (millions, A.R.)	1.47	1.43	2.05	2.36	2.05	1.34	1.23	1.66
Sales new autos (millions, A.R.)	9.57	8.40	10.24	10.93	11.44	8.87	8.48	9.96
Domestic models	8.46	7.12	8.68	9.32	9.67	7.45	6.86	8.25
Foreign models	1.11	1.28	1.56	1.61	1.77	1.42	1.62	1.71
^{1/} Net exports of g. & s. (Bal. of Paymts.)	1.3	2.9	- .2	-6.0	4.4	3.32 ^{2/}	8.93	-1.45
Exports	55.0	62.3	65.4	72.4	101.0	142.62 ^{2/}	143.0	157.1
Imports	53.6	59.4	65.6	78.4	96.6	139.4	134.1	158.6

^{2/} Includes shipments of military equipment and supplies to Israel which are not included in GNP exports; amounts in billions of dollars are: 1973, \$.6; 1974, \$.325; and 1975, \$.150.

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1969	1970	1971	1972	1973	1974	Projected	
							1975	1976
-----Billions of Dollars-----								
Gross National Product	66.1	46.8	77.8	103.1	136.9	102.5	70.5	167.5
Inventory change	.7	-3.3	1.8	2.2	6.9	-1.2	-76.8	23.5
Final purchases	65.4	50.1	76.0	100.9	130.1	103.6	97.3	144.0
Private	55.0	40.6	61.3	79.4	109.4	70.8	63.9	110.3
Net exports	-.6	1.7	-3.8	-5.8	9.9	-1.8	2.3	-10.4
Excluding net exports	55.6	38.9	65.1	85.2	99.5	72.6	61.6	120.6
Personal consumption expenditures	43.3	38.1	49.6	61.9	76.2	71.5	73.4	94.9
Durable goods	6.8	.5	12.6	14.5	11.9	-2.8	2.9	16.0
Nondurable goods	15.1	17.9	14.6	21.3	38.3	42.2	35.0	34.7
Services	21.4	19.9	22.2	26.1	26.0	32.1	35.6	44.1
Residential fixed investment	2.5	-1.4	11.6	11.2	3.2	-11.2	-7.8	15.0
Business fixed investment	9.7	2.1	4.0	12.2	20.0	12.4	-4.0	10.8
Government	10.4	9.5	14.7	21.5	20.7	32.8	33.4	33.7
Federal	.0	-2.6	1.4	7.3	1.7	10.3	13.2	10.5
State and local	10.4	12.1	13.3	14.2	19.0	22.5	20.3	23.2
GNP in constant (1958) dollars	19.0	-3.1	23.8	46.2	46.7	-18.0	-32.4	43.0
Final purchases	18.7	-.4	-27.5	-44.4	43.0	-15.9	-15.2	27.1
Private	20.6	6.2	18.5	46.1	45.2	-17.5	-17.7	29.5
-----Per Cent per Year-----								
Gross National Product	7.6	5.0	8.0	9.8	11.8	7.9	5.0	11.4
Final purchases	7.6	5.4	7.8	9.6	11.3	8.1	7.0	9.7
Private	8.4	5.7	8.1	9.7	12.2	7.1	5.9	9.7
Personal consumption expenditures	8.1	6.6	8.0	9.3	10.5	8.9	8.4	10.0
Durable goods	8.1	.6	13.8	14.0	10.1	-2.1	2.3	12.3
Nondurable goods	6.5	7.3	5.5	7.7	12.8	12.5	9.2	8.4
Services	9.7	8.2	8.5	9.2	8.4	9.5	9.6	10.9
Gross private domestic investment	10.3	-1.9	12.8	16.7	16.8	.0	-18.4	28.9
Residential structures	8.3	-4.3	37.2	26.2	5.9	-19.6	-17.0	39.3
Business fixed investment	10.9	2.1	4.0	11.7	17.1	9.1	-2.7	7.4
Gov't purchases of goods & services	5.2	4.5	6.7	9.2	8.1	11.9	10.8	9.8
Federal	.0	-2.6	1.5	7.5	1.6	9.7	11.3	8.1
Defense	.1	-4.8	-4.6	5.1	-.5	5.8	10.2	7.7
Other	-.5	5.9	22.7	13.6	7.0	18.6	13.6	8.8
State and local	10.3	10.9	10.8	10.4	12.6	13.3	10.6	10.9
GNP in constant (1958) dollars	2.7	-.4	3.3	6.2	5.9	-2.1	-3.9	5.4
Final purchases	2.7	-.1	3.1	6.0	5.5	-1.9	-1.9	3.4
Private	3.7	1.1	3.9	6.7	6.5	-2.6	-2.7	4.6
GNP implicit deflator	4.8	5.5	4.6	3.4	5.6	10.3	9.3	5.6
Private GNP fixed weighted index ^{1/}	4.7	4.8	4.3	3.3	6.3	11.4	9.3	5.4
Personal income	9.0	7.6	6.9	9.4	11.7	9.1	7.4	9.9
Wage and salary disbursements	9.6	6.3	5.8	9.3	10.4	8.6	4.7	8.3
Disposable income	7.3	9.0	7.9	7.5	12.6	8.4	8.9	8.5
Corporate profits before tax	-3.1	-12.8	13.0	18.7	23.7	14.7	-19.9	27.2
Federal Government receipts and expenditures (N.I.A. basis)								
Receipts	12.7	-2.7	3.4	14.5	13.8	12.6	-3.3	17.9
Expenditures	4.2	7.8	8.0	11.1	8.0	13.2	19.4	9.9
Nonfarm payroll employment	3.7	.7	.4	3.5	4.2	2.0	-1.9	2.1
Manufacturing	2.0	-4.1	-4.0	2.8	5.0	-.2	-8.5	3.2
Industrial production	4.7	-3.6	.1	7.9	9.0	-.7	-10.1	9.5
Housing starts, private	-2.7	-2.3	43.2	14.9	-13.2	-34.6	-8.2	35.0
Sales new autos	-.6	-12.3	21.9	6.7	4.7	-22.5	-4.4	17.5
Domestic models	-1.8	-15.9	21.9	7.4	3.7	-23.0	-7.9	20.3
Foreign models	9.0	15.5	21.8	3.3	9.8	-20.1	14.1	5.6

^{1/} Using expenditures in 1967 as weights.

DOMESTIC FINANCIAL SITUATION

Summary. Following the last Committee meeting, short-term market interest rates rose 75 to 100 basis points, paralleling similar increases in the Federal funds rate. During a period of record offerings of corporate bonds, the indications of a more restrictive monetary policy stance also contributed to increases in corporate bond yields of 30 to 60 basis points, and new offerings met increasing investor resistance even at these higher yields. While tax-exempt bond yields fluctuated in a narrow range, they remained near 7 per cent, only a little below the record highs reached late last year. Concerns regarding the quality of many new issues have tended to affect the entire municipal bond market, and a spillover from the size and yield of the New York City Municipal Assistance Corporation offering affected corporate bond yields as well. Home mortgage rates, on the other hand, supported by record inflows to thrift institutions and a late June step-up in FNMA activity, were virtually unchanged in both the primary and secondary markets.

Tax rebates and Social Security supplements probably played a significant role in the rapid pace of deposit inflows to depository institutions in June, with increases in passbook savings particularly strong at all types of such institutions. In late June, after the large Treasury disbursements ceased, inflows to the nonbank thrifts fell off sharply, but, for the month as a whole, these institutions apparently continued a high rate of new commitment activity and

residential mortgage acquisitions and still added large amounts to their liquid assets. Repayment of FHLB advances by S&L's slowed in June to less than \$350 million, apparently in part because of fears of slower net savings inflows late in the year. At the same time, as market interest rates rose, there were increased demands for FNMA forward commitments to purchase home mortgages by mortgage companies and other originators.

At commercial banks, loan demands remained weak, with total outstanding loans declining for the fifth consecutive month. Business loans were particularly weak as corporations expanded their already large volume of capital market financing. In May and June, however, banks stepped up their rate of purchase of tax-exempt securities, the first significant acquisitions since late 1974. Meanwhile banks have continued to purchase large amounts of Treasury issues. In the first half of the year, banks purchased an amount equal to almost 60 per cent of all net new Treasury issues (seasonally adjusted), as Table 1 shows. At the same time, households have been large liquidators of Treasury issues, shifting to interest-bearing deposits at banks and thrift institutions and high yielding corporate and State and local government bonds.

Outlook. In July and August, the Treasury may have to raise \$13-15 billion of new cash, as well as refund \$4.6 billion of maturing issues in August. Business corporations and State and local governments, taken together, are projected to be coming to capital

Table 1
 ESTIMATED ACQUISITIONS OF U.S. GOVERNMENT AND AGENCY
 SECURITIES BY SECTOR
 SEASONALLY ADJUSTED ANNUAL RATES
 FLOW OF FUNDS BASIS
 FIRST HALF OF 1975

	Billions of dollars	Per cent
TOTAL ISSUES ^{1/}	89.6	100.0
Net acquisitions		
Commercial banks	52.9	59.0
Private nonbank financial institutions	29.2	32.6
Foreign	14.4	16.1
Sponsored agencies	9.9	11.0
Federal Reserve	8.9	9.9
Corporate business	7.1	7.9
State and local Governments	4.2	4.7
Households	-36.9	-41.1

^{1/} Excludes U.S. Government lending to sponsored agencies that is included in Table 2, line 3.

markets for only a little less than in the spring and early summer, and foreign demands on capital markets are expected to be somewhat larger. On the other hand, consumer and short-term business credit demands seem likely to remain comparatively weak. The over-all pattern of credit demands is not significantly different from recent months and--barring any significant changes in supply--it thus appears that aggregate credit demands will not place upward pressure on interest rates in the near-term.

Indeed, staff projections for credit demands in the second half of 1975, shown in Table 2, suggest only modest changes in the size and composition of credit demands relative to the first half. All levels of government (line 1) are still the single largest demanders of funds, with the Treasury and sponsored agencies requiring somewhat less than in the first half and States and local governments somewhat more. Business credit demands (line 6) are expected to remain modest with short-term credit flows still declining as inventories are liquidated, cash flow increases, and capital market financing remains large. Residential mortgages borrowing (line 10) is expected to expand more rapidly than in the first half of the year as the current high volume of loan commitments is taken down.

Although aggregate credit demands are not expected to be very much different in either the near term or in the second half relative to the first half, the projected recovery in nominal GNP implies a sizable increase in transactions demand for money. Assuming

Table 2
FUNDS RAISED IN CREDIT MARKETS
 Seasonally adjusted annual rates
 Flow-of-funds basis
 1974-75
 (\$ billions)

	1974 H2	1975 H1	1975 H2 Proj.
1. ALL GOVERNMENTS -- TOTAL	63.0	107.9	96.0
2. U.S. Government <u>1/</u>	18.9	86.2	73.0
3. Sponsored agencies <u>2/</u>	27.4	4.6	-1.0
4. State and local	<u>16.7</u>	<u>17.1</u>	<u>24.0</u>
5. PRIVATE DOMESTIC NON-FINANCIAL & NON-GOV'T	125.6	71.4	81.0
6. Business	<u>79.3</u>	<u>38.3</u>	37.0
7. Short-term <u>3/</u>	42.4	-9.9	-4.0
8. Long-term <u>4/</u>	<u>36.9</u>	<u>48.2</u>	<u>40.0</u>
9. Consumer credit	6.6	-5.4	-1.0
10. Residential mortgages	35.7	35.4	43.0
11. Other	4.0	3.1	<u>2.0</u>
12. FOREIGN	10.9	--	3.0
13. CREDIT & EQUITY BORROWING OF PRIVATE FINANCIAL INSTITUTIONS <u>5/</u>	8.1	-8.9	3.0
14. TOTAL FUNDS RAISED IN CREDIT MARKETS	<u>207.5</u>	<u>170.3</u>	<u>183.0</u>

1/ Direct marketable and nonmarketable debt, savings bonds, and issues by on-budget and off-budget agencies.

2/ FNMA, FICB, Bank for Coops, Land Banks, and GNMA Guaranteed Mortgage backed securities.

3/ Business bank loans and open market paper.

4/ Bonds, equities, and non-residential mortgages.

5/ Includes FHLB advances to savings and loan associations as follows:

1974 H2: \$6.5 billion

1975 H1: -\$11.6 billion

1975 H2: -\$6.0 billion.

Table 3
 FUNDS ADVANCED IN CREDIT MARKET
 Seasonally adjusted annual rates
 Flow of funds basis
 1974-75
 (\$ billions)

	1974 H2	1975 H1	1975 H2 Proj.
1. PRIVATE FINANCIAL INSTITUTIONS	113.1	129.3	133.0
2. Domestic commercial banks and affiliates	41.3	34.9	52.0
3. Thrift institutions <u>1/</u>	19.9	52.3	37.0
4. Insurance and pension funds <u>2/</u>	44.2	42.0	42.0
5. All other <u>3/</u>	<u>7.7</u>	<u>.1</u>	<u>2.0</u>
6. U.S. GOVERNMENT	46.4	30.7	20.0
7. Direct <u>4/</u>	12.5	14.5	8.0
8. Sponsored credit agencies <u>5/</u>	27.6	7.2	1.0
9. Federal Reserve	<u>6.2</u>	<u>9.0</u>	11.0
10. HOUSEHOLDS	29.5	-21.2	-8.0
11. ALL OTHER <u>6/</u>	<u>18.6</u>	<u>31.5</u>	<u>38.0</u>
12. TOTAL FUNDS ADVANCED IN CREDIT MARKETS	<u>207.5</u>	<u>170.3</u>	<u>183.0</u>

- 1/ Savings and loan associations, mutual savings banks, and credit unions.
2/ Life and other insurance companies, private and public pension funds.
3/ Finance companies, REIT's, open-end investment companies, and securities
 brokers and dealers.
4/ Lending by on-budget and off-budget agencies.
5/ FNMA, FHLB, FICB, Land Banks, Banks for Coops. Includes mortgage pools
 GNMA guaranteed securities.
6/ Businesses, state and local governments, and rest of world.

bank reserves are supplied at a pace consistent with M1 growth in a 5--7-1/2 per cent range, it appears likely that short-term interest rates will rise later in the year. As a result, inflows to thrift institutions (line 3 of Table 3)--no longer buoyed by tax refunds and rebates--would be expected to slow appreciably. In the staff projections, therefore, by the fourth quarter the thrift institutions rate of inflow drops to a rate just equal to mortgage takedowns and liquid asset holdings of these institutions are no longer growing. This projection implies that an even more cautious lending attitude is likely to develop among thrift institutions later this year. Banks, too, may be expected to become somewhat more restrictive in their loan policies as their costs of funds rise.

INTERNATIONAL DEVELOPMENTS

Summary. The international accounts of the United States have strengthened recently, evidenced by a sizable and sustained trade surplus beginning in February and, more recently, by a considerable rise of the dollar in foreign exchange markets. Much of the gain in the trade balance has resulted from the earlier and steeper cyclical decline in economic activity in the United States than in other industrial countries. The 20 per cent depreciation of the dollar, on a weighted average basis, since 1970 also continues to affect the level of exports and imports. Of more significance for recent changes in the dollar exchange rate, however, has been the relative rise of interest rates on dollar assets in the past month. On a weighted average basis, the dollar advanced by about 2-1/4 per cent in the last two weeks, after having held roughly steady for about three months.

Declines in economic activity everywhere have sharply reduced the physical volume of world trade. U.S. exports in volume terms were about 3 per cent lower in the January-May period than in the last half of 1974, while import volumes were down about 16 per cent. Though only partial data are available, there appears to have been a steep drop in trade volumes for all OECD countries combined, clearly the deepest contraction of world trade since World War II.

A large part of the reduction in U.S. exports in volume, and even more in value, is accounted for by the decline in agricultural exports since early in the year, reflecting the generally improved outlook for world food supplies. The most striking element in the U.S. trade picture, however, has been the extent of the decline in non-fuel imports after January. This sharp drop, from an annual rate of over \$80 billion through January to about \$65 billion in April-May, is largely attributable to the massive liquidation of inventories in the United States -- with import reductions showing up largely in industrial supplies. On the export side, also, a large portion of the decline in shipments reflects a drop in industrial supplies, related to some inventory contraction abroad. As a result of these developments, the trade balance in April-May registered a surplus at an annual rate of \$8.4 billion, compared to \$7.4 billion in the first quarter.

Net outflows of private capital (changes in net foreign assets of banks and transactions in securities) rose sharply in May; there had been a small net inflow in April. In May net outflows through banks were about \$2.8 billion, as claims on foreigners rose by \$2-1/2 billion and liabilities -- principally to foreign banks -- were reduced slightly. Weekly data for June suggest that liabilities to foreign banks may have been reduced further, but rising interest rates in the United States may have slowed down the rate of lending to foreigners.

There has been a considerable rise this year both in U.S. purchases of new foreign bonds offered in the U.S. market, and in foreign net purchases of U.S. corporate stocks, with a small net inflow on balance in these accounts in April and May. A large part, perhaps half, of the foreign purchases of U.S. corporate stocks has been by oil-producing countries, allowing for some indirect purchases recorded for other countries. Sales of foreign bonds in the United States were at a record rate in the first quarter, when they totaled \$2.1 billion, but they slowed down to a quarterly rate of about \$1-1/4 billion in the second quarter. There are indications that the volume of foreign bonds sold here will remain high by past standards, but at the same time U.S. corporations may again find it advantageous to sell their bonds in offshore markets after having done little in this market since the direct investment controls were removed.

U.S. liquid liabilities to foreign official accounts were increased by about \$700 million in May -- about evenly divided between OPEC and other countries. Through May liquid U.S. assets of OPEC countries had increased by about \$1½ billion, plus about \$1/2 billion of recorded investment in U.S. corporate stocks. This rate of inflow is much lower than in the last half of 1974, as is the flow into London, but it is not yet clear whether the change reflects diversification into other assets or a sharp decline in the OPEC surplus. Partial data for June continue to show a diminished OPEC flow into U.S. assets.

Outlook. The prospects for an upturn in economic activity abroad remain cloudy, both as to timing and vigor. Of the two other major OECD economies, Japan and Germany, the former has probably begun to recover, but in Germany there has as yet been no indication of an upturn and the authorities will wait until August to review the situation. Even when convincing upturns come in these countries, and the smaller economies that will be pulled along, the margins of unused resources will be large for some considerable time. The smaller OECD countries, and the developing countries that do not produce oil, must be feeling severely the contraction of major countries' imports, and will need to hold down their own imports, adding to the difficulties of stimulating an economic recovery.

In the shorter run, the likelihood that the U.S. economy will pick up steam before most other economies may strengthen the dollar in exchange markets, in reaction to projected rising interest rates here. At the same time, however, the U.S. trade balance is expected to fall back from recent surpluses and probably revert to deficits around the end of the year.