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CONFIDENTIAL (FR)

February 22, 1978

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Economic activity was adversely effected by bad weather in January. Given the strong performance of final demands and emergence of lean inventory positions late last year, prospects favor a resurgence of activity such as occurred following the bad weather of early 1977. However, the vigor of the rebound may be affected by the coal strike and lackluster consumer demand for domestic autos.

Nonfarm payroll employment rose nearly a quarter of a million from December to January--factory hiring accounted for an appreciable portion of the rise--and the unemployment rate edged down 0.1 percentage point to 6.3 per cent. However, bad weather interrupted normal work schedules, and the average workweek declined half an hour. As a result, total labor input declined in January.

Industrial production declined--seven tenths of 1 per cent--reflecting widespread reductions in output. The largest drop occurred in the motor vehicles sector as auto assemblies were cut, apparently mainly to bring inventories into better balance. Production of business equipment declined half a per cent (partly because of cuts in truck output), and production of coal fell somewhat further.

Residential construction activity was especially hard hit by bad weather. Total private housing starts fell to a 1.55 million unit annual rate in January, from a (downward-revised) 2.2 million unit rate in December. Starts of both single-family and multifamily units declined sharply, with all sections of the nation affected substantially.

Retail sales excluding autos and nonconsumption items declined 2.4 per cent in January, an unusually steep drop. Sales were off sharply at apparel, general merchandise, and furniture and appliance outlets. Unit auto sales sagged further in January as sales of domestic autos, which reportedly have been inhibited by consumer resistance to downsized intermediate cars as well as higher prices, slipped to an 8 million unit annual rate.

Given the strong pace of final sales and the moderate rise of industrial production late last year, the book value of manufacturing and trade inventories was little changed in December and up only moderately for the fourth quarter as a whole. Total inventories of durable goods increased somewhat further in December, while nondurable stocks declined. Inventory-sales ratios were generally quite low by historical standards at year-end, probably presaging a stronger pattern of industrial output as sales advance.

Prospects for business spending on equipment continue reasonably favorable. New orders for nondefense capital goods rose 9.1 per cent in December, and orders for machinery--usually an indicator of future investment plans--increased sharply. The dollar value of construction contracts for new industrial and commercial buildings also rose in December, but for the fourth quarter as a whole, such contracts were down slightly from the advanced third quarter level.

State and local government units apparently continued to pursue conservative spending policies in the aggregate. Despite Federally subsidized employment programs, job growth at State and local levels was small in January and spending on capital projects remained well below earlier levels.

Prices of finished goods at wholesale increased 0.6 per cent last month, about the same as the pace since September. However, prices of goods and materials at earlier stages of processing, which accelerated late last year, continued to rise quite rapidly. Consumer prices rose 0.4 per cent in December, the latest month for which data are available. The index of hourly earnings rose more rapidly in January than earlier as the higher minimum wage became effective.

Outlook. Adverse weather now is expected to hold real GNP growth in the first quarter to around a 4-1/2 per cent annual rate, about one percentage point less than anticipated last month. While we expect a resurgence of retail sales as the weather improves, consumption in real terms now is projected to rise by only about 1-1/2 per cent in the first quarter--well below the average increase last year. In large part because of bad weather, residential building and business fixed investment are expected to run below our earlier estimates for this quarter. At the same time, inventory investment is still projected to pick up this quarter following the reduced pace in the fourth quarter.

Fiscal and monetary policy assumptions underlying the staff projection are essentially unchanged this month. We continue to assume a tax cut of about \$25 billion effective October 1 of this year, with two-thirds of the reduction accruing to individuals. Our estimate of FY 1978 Federal outlays has been raised to \$458.5 billion. This increase in projected spending is more than offset by an upward adjustment of our receipts estimate and, as a result, the projected deficit for the current fiscal year has been lowered to about \$60 billion and is expected to rise to \$64 billion in FY 1979. Our monetary policy assumption still calls for M-1 growth along a 5-1/4 per cent annual rate path through 1979-QII. Short-term interest rates are expected to move up during this year, with the bulk of the rise occurring by the summer of 1978.

Following the current quarter, real GNP growth is expected to average just over 4-1/2 per cent (annual rate) through mid-1979--close to the pace anticipated last month. However, some realignments have been made within the totals. Most notably, projected residential construction outlays have been lowered in light of the recent and prospective slowing in thrift deposit inflows and the associated tighter mortgage market conditions. Projected government purchases were revised down somewhat as a result of new Federal budget data and the fourth quarter pattern of expenditures. By contrast, somewhat larger near-term gains are expected in both consumption and inventories as activity recovers from the recent bout with bad weather.

In general, we continue to anticipate that the expansion projected through mid-1979 will be supported importantly by business investment activity, with inventory accumulation picking up and real fixed capital outlays proceeding at close to a 6 per cent annual rate. Despite the projected tax cut, consumer outlays are expected to slow somewhat from the strong growth earlier in the recovery, as deferred demands are fulfilled, debt burdens grow and income growth slows from the cyclically advanced rate of the early stage of the expansion.

The expected growth of real output remains consistent with a reduction of about one-half a percentage point in the unemployment rate to below 6 per cent by the end of the projection period. Growth of labor productivity in nonfarm businesses continues to be projected in the 2-1/2 per cent range while the increase of compensation still appears likely to average about 9 per cent. Thus, unit labor costs appear likely to average above 6 per cent, sustaining an underlying inflation rate in the same neighborhood.

Details of the staff projection are shown in the tables that follow.

STAFF GNP PROJECTIONS

	Per cent changes, annual rate							
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	1/11/78	2/22/78	1/11/78	2/22/78	1/11/78	2/22/78	1/11/78	2/22/78
1974 ^{1/}	8.1	8.1	-1.4	-1.4	10.4	10.4	5.6	5.6
1975 ^{1/}	8.2	8.2	-1.3	-1.3	9.5	9.5	8.5	8.5
1976 ^{1/}	11.6	11.6	6.0	6.0	5.4	5.4	7.7	7.7
1977 ^{1/}	10.8	10.8	5.0	4.9	6.0	6.0	7.1	7.0
1978	11.6	11.1	4.9	4.6	6.2	6.2	6.4	6.2
1977-III ^{1/}	10.2	10.2	5.1	5.1	5.0	5.0	7.0	6.9
1977-IV ^{1/}	11.6	10.4	4.5	4.0	6.0	5.5	6.8	6.6
1978-I	12.5	11.8	5.4	4.4	6.6	6.8	6.5	6.3
1978-II	11.0	11.0	4.5	4.6	6.3	6.4	6.4	6.2
1978-III	10.9	10.4	4.4	4.2	6.6	6.2	6.4	6.2
1978-IV	12.3	11.8	5.1	4.8	6.3	6.2	6.3	6.1
1979-I	11.9	11.9	5.1	5.0	6.6	6.7	6.1	6.0
1979-II	10.8	10.8	4.5	4.5	6.4	6.4	6.0	5.9
Change:								
76-IV to 77IV ^{1/}	12.2	11.9	5.8	5.7	6.3	6.2	-1.1	-1.2
77-II to 78-II	11.3	10.8	4.9	4.5	5.9	5.9	-.6	-.9
77-IV to 78-IV	11.7	11.3	4.8	4.5	6.5	6.4	-.5	-.5
78-II to 79-II	11.5	11.2	4.8	4.6	6.5	6.4	-.4	-.3

^{1/} Actual.

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

	1977		1978				1979	
	III	IV	I	II	Projected		I	II
Gross National Product	1915.9	1963.7	2019.3	2072.7	2124.5	2184.7	2246.8	2305.4
Final purchases	1892.2	1953.0	2004.6	2051.9	2101.7	2159.9	2217.3	2274.1
Private	1491.3	1539.6	1581.8	1619.6	1659.4	1704.8	1751.8	1798.0
Excluding net exports	1498.8	1554.7	1589.6	1631.1	1671.9	1717.3	1763.5	1809.0
Personal consumption expenditures	1218.9	1260.2	1285.3	1317.6	1350.7	1388.7	1427.1	1464.4
Goods	659.4	686.3	694.4	712.7	730.8	752.7	772.4	791.7
Services	559.5	573.9	590.9	604.9	619.9	636.0	654.7	672.7
Gross private domestic investment	303.6	305.2	319.0	334.3	344.0	353.4	365.9	375.9
Residential construction	92.5	99.6	104.1	107.1	108.6	109.6	110.6	111.6
Business fixed investment	187.5	194.9	200.2	206.4	212.6	219.0	225.8	233.0
Change in business inventories	23.6	10.7	14.7	20.8	22.8	24.8	29.5	31.3
Nonfarm	23.1	6.2	10.7	17.3	19.8	21.8	26.5	28.3
Net exports of goods and services ^{1/}	-7.5	-15.1	-7.8	-11.5	-12.5	-12.5	-11.7	-11.0
Exports	179.9	173.6	187.9	193.6	201.0	208.0	215.7	222.0
Imports	187.4	188.7	195.7	205.1	213.5	220.5	227.4	233.0
Gov't. purchases of goods and services	400.9	413.4	422.8	432.3	442.3	455.1	465.5	476.1
Federal ^{2/}	148.1	153.8	156.2	158.7	161.7	167.2	170.5	174.1
State and local	252.9	259.6	266.6	273.6	280.6	287.9	295.0	302.0
Gross national product in constant (1972) dollars	1347.4	1360.7	1375.4	1390.9	1405.2	1421.9	1439.4	1455.2
Personal income	1549.8	1602.8	1641.6	1683.2	1732.0	1779.0	1822.8	1867.0
Wage and salary disbursements	998.9	1028.5	1053.8	1078.2	1103.9	1133.5	1164.2	1191.3
Disposable income	1323.8	1368.2	1403.0	1436.6	1475.5	1529.1	1568.8	1604.6
Saving rate (per cent)	5.5	5.5	6.0	5.8	6.0	6.8	6.6	6.3
Corporate profits with I.V.A. and C.C. Adj.	149.0	143.6	148.3	153.7	153.1	161.9	161.3	165.1
Corporate profits before tax	172.8	177.1	184.3	190.2	190.2	199.7	199.6	203.9
Federal government surplus or deficit (-) (N.I.A. basis)	-58.9	-61.5	-56.1	-52.5	-49.8	-64.9	-56.2	-48.8
High employment surplus or deficit (-)	-20.4	-21.9	-18.6	-16.0	-11.6	-30.7	-22.0	-15.6
State and local government surplus or deficit (-) (N.I.A. basis)	32.9	31.6	29.1	28.8	26.3	25.3	22.9	20.6
Excluding social insurance funds	17.6	15.9	11.6	10.8	7.8	6.3	3.4	.6
Civilian labor force (millions)	97.6	98.6	99.2	99.8	100.4	101.0	101.6	102.1
Unemployment rate (per cent)	6.9	6.6	6.3	6.2	6.2	6.1	6.0	5.9
Nonfarm payroll employment (millions)	82.5	83.2	83.9	84.5	85.1	85.8	86.5	87.1
Manufacturing	19.6	19.8	20.0	20.2	20.4	20.6	20.9	21.1
Industrial production (1967=100)	138.4	139.3	139.8	142.8	145.2	147.9	150.8	153.3
Capacity utilization: all manufacturing (per cent)	83.0	82.9	82.3	83.3	83.9	84.5	85.2	85.7
Materials (per cent)	82.3	82.2	81.5	82.8	83.6	84.4	85.6	86.0
Housing starts, private (millions, A.R.)	2.04	2.14	1.85	2.05	1.90	1.80	1.80	1.80
Sales new autos, (millions, A.R.)	10.92	10.75	10.60	10.85	10.90	11.05	11.10	10.95
Domestic models	8.88	8.77	8.50	8.75	8.90	9.10	9.15	9.10
Foreign models	2.04	1.98	2.10	2.10	2.00	1.95	1.95	1.85

^{1/} Balance of payments data and projection underlying these estimates are shown in the International Development section of this part of the Greenbook.

^{2/} Components of purchases and total receipts and total expenditures are shown in the Federal Sector Accounts table which follows.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1977		1978				1979	
	III	IV	Projected				I	II
			I	II	III	IV		
	----- Billions of dollars -----							
Gross National Product	46.0	47.8	55.6	53.4	51.8	60.2	62.1	58.6
Inventory change	1.9	-12.9	4.0	6.1	2.0	2.0	4.7	1.8
Final purchases	44.0	60.8	51.6	47.3	49.8	58.2	57.4	56.8
Private	33.7	48.3	42.4	37.8	39.8	45.4	47.0	46.2
Net exports	2.2	-7.6	7.3	-3.7	-1.0	-.0	.8	.7
Excluding net exports	31.5	55.9	34.9	41.5	40.8	45.4	46.2	45.5
Personal consumption expenditures	24.9	41.3	25.1	32.3	33.1	38.0	38.4	37.3
Goods	6.4	26.9	8.1	18.3	18.1	21.9	19.7	19.3
Services	18.4	14.4	17.0	14.0	15.0	16.1	18.7	18.0
Residential fixed investment	1.7	7.1	4.5	3.0	1.5	1.0	1.0	1.0
Business fixed investment	5.1	7.4	5.3	6.2	6.2	6.4	6.8	7.2
Government	10.3	12.5	9.4	9.5	10.0	12.8	10.4	10.6
Federal	4.5	5.7	2.4	2.5	3.0	5.5	3.3	3.6
State and local	5.9	6.7	7.0	7.0	7.0	7.3	7.1	7.0
GNP in constant (1972) dollars	16.7	13.3	14.7	15.5	14.4	16.7	17.4	15.8
Final purchases	14.3	22.0	12.4	11.7	13.0	15.6	14.7	14.7
Private	10.3	19.3	10.0	9.3	10.8	13.7	12.4	12.2
	----- In Per Cent Per Year ^{1/} -----							
Gross National Product	10.2	10.4	11.8	11.0	10.4	11.8	11.9	10.8
Final purchases	9.9	13.5	11.0	9.8	10.1	11.5	11.1	10.6
Private	9.6	13.6	11.4	9.9	10.2	11.4	11.5	11.0
Personal consumption expenditures	8.6	14.3	8.2	10.4	10.4	11.7	11.5	10.9
Goods	4.0	17.3	4.8	11.0	10.6	12.5	10.9	10.4
Services	14.3	10.7	12.4	9.8	10.3	10.8	12.3	11.5
Gross private domestic investment	12.4	2.1	19.4	20.6	12.1	11.4	14.9	11.4
Residential structures	7.7	34.6	19.3	12.0	5.7	3.7	3.7	3.7
Business fixed investment	11.6	16.6	11.3	13.0	12.6	12.6	13.0	13.4
Gov't. purchases of goods and services	11.0	13.1	9.4	9.3	9.6	12.1	9.5	9.4
Federal	12.9	16.4	6.4	6.6	7.8	14.3	8.1	8.7
State and local	9.9	11.2	11.2	10.9	10.6	10.8	10.2	9.8
GNP in constant (1972) dollars	5.1	4.0	4.4	4.6	4.2	4.8	5.0	4.5
Final purchases	4.4	6.8	3.7	3.5	3.8	4.6	4.3	4.2
Private	4.0	7.5	3.8	3.5	4.0	5.0	4.5	4.4
GNP implicit deflator ^{2/}	4.8	6.1	7.1	6.1	5.9	6.7	6.5	6.1
Gross business product fixed-weighted price index ^{3/}	5.0	5.5	6.8	6.4	6.2	6.2	6.7	6.4
Personal income	8.9	14.4	10.0	10.5	12.1	11.3	10.2	10.1
Wage and salary disbursements	7.5	12.4	10.2	9.6	9.9	11.2	11.3	9.6
Disposable income	10.0	14.1	10.6	9.9	11.3	15.3	10.8	9.5
Corporate profits before tax	-2.7	10.2	17.2	13.5	.1	21.5	-.2	8.8
Nonfarm payroll employment	3.3	3.2	3.6	2.6	2.6	3.3	3.5	2.8
Manufacturing	1.3	2.7	5.1	4.1	4.4	4.2	4.5	4.2
Nonfarm business sector								
Output per hour	3.8	1.2	2.7	2.3	2.2	2.4	2.5	2.1
Compensation per hour	7.5	7.5	11.9	7.5	7.8	7.9	11.3	8.0
Unit labor costs	3.5	6.1	9.2	5.2	5.6	5.5	8.8	5.9
Industrial production	4.2	2.6	1.4	8.9	6.9	7.6	8.1	6.8
Housing starts, private	22.1	21.6	-44.5	50.8	-26.2	-19.4	.0	.0
Sales new autos	-24.1	-6.2	-5.5	9.8	1.9	5.6	1.8	-5.3
Domestic models	-18.4	-4.8	-11.9	12.3	7.0	9.3	2.2	-2.2
Foreign models	-43.9	-12.3	27.3	.0	-17.7	-9.6	.0	-19.0

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

^{2/} Excluding Federal pay increases rates of change are: 1977-IV, 5.4 per cent; 1978-I, 7.1 per cent; 1978-IV, 6.0 per cent; 1979-I, 6.5 per cent.

^{3/} Using expenditures in 1972 as weights.

February 22, 1978

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SS II FOMCGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Expenditures and income figures are billions of dollars)

	1971	1972	1973	1974	1975	1976	1977	Projected 1978
Gross National Product	1063.4	1171.1	1306.6	1412.9	1528.8	1706.5	1890.1	2100.3
Final purchases	1057.1	1161.7	1288.6	1404.0	1540.3	1693.1	1872.6	2079.5
Private	823.4	908.6	1019.1	1101.3	1201.4	1331.7	1477.7	1641.4
Excluding net exports	821.8	911.9	1012.0	1095.3	1181.0	1323.9	1487.8	1652.5
Personal consumption expenditures	668.2	733.0	809.9	889.6	980.4	1094.0	1211.4	1335.6
Goods	374.8	410.5	457.5	498.3	542.2	601.6	660.6	722.6
Services	293.4	322.4	352.3	391.3	438.2	492.3	550.8	612.9
Gross private domestic investment	160.0	188.3	220.0	214.6	189.1	243.3	293.9	337.7
Residential construction	49.6	62.0	66.1	55.1	51.5	68.0	91.0	107.3
Business fixed investment	104.1	116.8	136.0	150.6	149.1	161.9	185.5	209.5
Change in business inventories	6.4	9.4	17.9	8.9	-11.5	13.3	17.4	20.8
Nonfarm	5.1	8.8	14.7	10.8	-15.1	14.9	16.4	17.4
Net exports of goods and services	1.6	-3.3	7.1	6.0	20.4	7.8	-10.1	-11.1
Exports	65.6	72.7	101.6	137.9	147.3	162.9	175.5	197.6
Imports	64.0	75.9	94.4	131.9	126.9	155.1	185.6	208.7
Gov't. purchases of goods and services	233.7	253.1	269.5	302.7	338.9	361.4	394.9	438.1
Federal	96.2	102.1	102.2	111.1	123.3	130.1	145.5	160.9
State and local	137.5	151.0	167.3	191.5	215.6	231.2	249.5	277.2
Gross national product in constant (1972) dollars	1107.5	1171.1	1235.0	1217.8	1202.1	1274.7	1337.5	1398.4
Personal income	859.1	942.5	1052.4	1154.9	1253.4	1382.7	1536.7	1708.9
Wage and salary disbursements	579.4	633.8	701.3	764.6	805.7	891.8	989.9	1092.3
Disposable income	742.8	801.3	901.7	984.6	1084.4	1185.8	1309.2	1461.0
Saving rate (per cent)	7.7	6.2	7.8	7.3	7.4	5.6	5.1	6.2
Corporate profits with I.V.A. and C.C. Adj.	77.2	92.1	99.1	83.6	99.3	128.1	139.3	154.2
Corporate profits before tax	82.0	96.2	115.8	126.9	123.5	156.9	171.2	191.1
Federal government surplus or deficit (-) (N.I.A. basis)	-22.0	-17.3	-6.7	-10.7	-70.2	-54.0	-49.9	-55.8
High employment surplus or deficit (-)	-5.3	-5.9	-7	17.1	-20.3	-10.4	-8.6	-19.2
State and local government surplus or deficit (-) (N.I.A. basis)	3.7	13.7	13.0	7.5	5.9	18.4	29.3	27.4
Excluding social insurance funds	-3.8	5.6	4.1	-2.9	-6.2	3.9	13.7	9.1
Civilian labor force (millions)	84.1	86.5	88.7	91.0	92.6	94.8	97.4	100.1
Unemployment rate (per cent)	5.9	5.6	4.9	5.6	8.5	7.7	7.0	6.2
Nonfarm payroll employment (millions)	71.2	73.7	76.9	78.4	77.1	79.4	82.1	84.8
Manufacturing	18.6	19.1	20.1	20.0	18.3	19.0	19.6	20.3
Industrial production (1967=100)	109.6	119.7	129.8	129.3	117.8	129.8	137.0	143.9
Capacity utilization: all manufacturing (per cent)	78.0	83.1	87.5	84.2	73.6	80.2	82.4	83.5
Materials (per cent)	83.1	88.0	92.4	87.7	73.6	80.4	81.9	83.1
Housing starts, private (millions, A.R.)	2.05	2.36	2.05	1.34	1.16	1.54	1.99	1.90
Sales new autos (millions, A.R.)	10.24	10.93	11.42	8.91	8.66	10.12	11.13	10.85
Domestic models	8.68	9.32	9.65	7.49	7.08	8.63	9.07	8.81
Foreign models	1.56	1.61	1.77	1.42	1.58	1.50	2.06	2.04

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1971	1972	1973	1974	1975	1976	1977	Projected 1978
----- Billions of Dollars -----								
Gross National Product	81.0	107.7	135.5	106.3	115.9	177.7	183.6	210.2
Inventory change	2.6	3.0	8.5	-9.0	-20.4	24.8	4.1	3.4
Final purchases	78.5	104.6	126.9	115.4	136.3	152.8	179.5	206.9
Private	63.7	85.2	110.5	82.2	100.1	130.3	146.0	163.7
Net exports	-2.3	-4.9	10.4	-1.1	14.4	-12.6	-17.9	-1.0
Excluding net exports	66.0	90.1	100.1	83.3	85.7	142.9	163.9	164.7
Personal consumption expenditures	49.4	64.8	76.9	79.7	90.8	113.6	117.4	124.2
Goods	25.2	35.7	47.0	40.8	43.9	59.4	59.0	62.0
Services	24.3	29.0	29.9	39.0	46.9	54.1	58.5	62.1
Residential fixed investment	13.0	12.4	4.1	-11.0	-3.6	16.5	23.0	16.3
Business fixed investment	3.6	12.7	19.2	14.6	-1.5	12.8	23.6	24.0
Government	14.8	19.4	16.4	33.2	36.2	22.5	33.5	43.2
Federal	.6	5.9	.1	8.9	12.2	6.8	15.4	15.4
State and local	14.3	13.5	16.3	24.2	24.1	15.6	18.3	27.7
GNP in constant (1972) dollars	32.2	63.6	63.9	-17.2	-15.7	72.6	62.8	60.9
Final purchases	29.9	60.8	56.8	-8.6	2.1	54.2	59.9	59.3
Private	30.7	57.1	57.4	-13.8	-3.2	52.8	53.3	48.0
----- In Per Cent Per Year -----								
Gross National Product	8.2	10.1	11.6	8.1	8.2	11.6	10.8	11.1
Final purchases	8.0	9.9	10.9	8.9	9.7	9.9	10.6	11.0
Private	8.4	10.3	12.2	8.1	9.1	10.8	11.0	11.1
Personal consumption expenditures	8.0	9.7	10.5	9.8	10.2	11.6	10.7	10.3
Goods	7.2	9.5	11.4	8.9	8.8	11.0	9.8	9.4
Services	9.0	9.9	9.3	11.1	12.0	12.4	11.9	11.3
Gross private domestic investment	13.6	17.7	16.8	-2.5	-11.9	28.7	20.8	14.9
Residential structures	35.5	25.1	6.6	-16.7	-6.5	32.2	33.7	17.9
Business fixed investment	3.6	12.3	16.4	10.8	-1.0	8.6	14.5	12.9
Gov't. purchases of goods and services	6.8	8.3	6.5	12.3	12.0	6.6	9.3	10.9
Federal	.6	6.1	.1	8.7	11.0	5.5	11.8	10.6
State and local	11.6	9.8	10.8	14.5	12.6	7.2	7.9	11.1
GNP in constant (1972) dollars	3.0	5.7	5.5	-1.4	-1.3	6.0	4.9	4.6
Final purchases	2.8	5.5	4.9	-.7	.2	4.5	4.7	4.5
Private	3.7	6.7	6.3	-1.4	-.3	5.6	5.3	4.5
GNP implicit deflator	5.1	4.1	5.8	9.7	9.6	5.3	5.6	6.3
Gross business product fixed-weighted index ^{1/}	4.4	3.3	5.7	10.4	9.5	5.4	6.0	6.2
Personal income	7.2	9.7	11.7	9.7	8.5	10.3	11.1	11.2
Wage and salary disbursements	6.0	9.4	10.7	9.0	5.4	10.7	11.0	10.3
Disposable income	8.3	7.9	12.5	9.2	10.1	9.4	10.4	11.6
Corporate profits before tax	14.7	17.3	20.4	9.6	-2.7	27.0	9.1	11.6
Nonfarm payroll employment	.4	3.5	4.3	2.0	-1.7	3.1	3.4	3.2
Manufacturing	-4.0	2.8	5.1	-.1	-8.5	3.3	3.2	3.9
Nonfarm business sector								
Output per hour	2.9	3.0	1.7	-2.9	1.6	4.1	2.0	2.5
Compensation per hour	6.6	5.8	7.8	9.4	9.6	8.7	8.5	8.8
Unit labor costs	3.5	2.7	6.0	12.7	7.9	4.5	6.4	6.3
Industrial production	1.7	9.2	8.4	-.4	-8.9	10.2	5.5	5.0
Housing starts	43.1	14.9	-13.2	-34.6	-13.3	32.5	29.2	-4.4
Sales new autos	21.9	6.8	-4.7	-14.5	-2.8	16.9	9.9	-2.5
Domestic models	21.9	7.4	3.5	-22.4	-5.5	21.9	5.1	-2.9
Foreign models	21.8	3.1	9.7	-19.9	11.4	-5.1	37.2	-.8

Using expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

February 22, 1978

	Fiscal Year 1977*	FY 1978 ^{e/}					CY 1977*		CY 1978 ^{e/}		Calendar quarters; unadjusted data							
		Admin.		F.R.	Cong.	F.R.		F.R.		1977				F.R. staff estimates 1978				
		est. 1/	Board	est. 2/	Board	Board	Board	I*	II*	III*	IV*	I	II	III	IV			
Unified budget receipts	356.9	400.4	398.2	397.0	365.2	406.7	79.0	110.5	91.3	84.5	84.2	123.1	106.4	93.0				
Unified budget outlays	401.9	462.2	458.5	458.3	416.1	467.1	97.6	101.8	103.4	113.3	111.4	114.4	119.3	122.0				
Surplus (+)/Deficit(-), unified budget	-45.0	-61.8	-60.3	-61.3	-50.9	-60.4	-18.7	8.6	-12.2	-28.8	-27.2	8.7	-12.9	-29.0				
Surplus(+)/Deficit(-), off-budget agencies <u>3/</u>	-8.7	-11.5	-10.5	n.a.	-10.4	-10.9	-4.3	0.1	-4.9	-1.3	-3.7	-1.1	-4.4	-1.7				
Means of financing combined deficits:																		
Net borrowing from public	53.5	66.0	59.3	n.a.	56.8	67.7	17.6	-1.1	19.6 ^{8/}	20.7 ^{8/}	23.7	0.9	14.0	29.1				
Decrease in cash operating balance	-1.7	n.a.	7.1	n.a.	-0.6	0.3	2.6	-7.2	-2.8 ^{8/}	6.8 ^{8/}	4.3	-8.0	4.0	0				
Other <u>4/</u>	1.9	n.a.	4.3	n.a.	5.3	3.3	2.7	-0.4	0.4	2.6	2.9	-0.5	-0.7	1.6				
Cash operating balance, end of period	19.1	n.a.	12.0	n.a.	12.3	12.0	9.0	16.3	19.1 ^{8/}	12.3	8.0	16.0	12.0	12.0				
Memo: Sponsored agency borrowing <u>5/</u>	5.2	n.a.	18.0	n.a.	6.8	20.9	0.7	3.0	1.1	2.0	4.7	5.4	5.9	4.9				
<u>NIA Budget</u>																		
							Seasonally adjusted annual rates											
Receipts	361.9 ^{6/}	410.8	404.1 ^{6/}	n.a.	373.7	416.6	364.9	371.2	373.2	385.3	398.3	410.4	429.0	428.7				
Outlays	411.9	463.6	460.8	n.a.	423.5	472.5	403.7	411.5	432.1	446.7	454.4	463.3	478.8	493.6				
Purchases (total)	140.6	158.4	157.6	n.a.	145.5	161.0	136.3	143.6	148.1	153.8	156.2	158.7	161.7	167.2				
Defense	91.8	99.8	99.7	n.a.	94.3	101.2	89.7	93.4	95.6	98.5	99.4	100.0	100.9	104.3				
Non-defense	48.8	58.6	57.9	n.a.	51.2	59.8	46.7	50.2	52.5	55.3	56.8	58.7	60.8	62.9				
All other outlays	271.4 ^{6/}	305.2	303.2 ^{6/}	n.a.	278.0	311.5	267.4	267.9	284.0	292.9	298.2	304.6	317.1	326.4				
Surplus(+)/Deficit (-)	-50.0 ^{6/}	-52.8	-56.7 ^{6/}	n.a.	-49.8	-55.9	-38.8	-40.3	-58.9	-61.4	-56.1	-52.9	-49.8	-64.9				
High Employment Surplus(+)/Deficit (-) (NIA basis) <u>7/</u>	-5.0	n.a.	-17.0	n.a.	-8.6	-19.2	7.5	0.2	-20.4	-21.9	-18.6	-16.0	-11.6	-30.7				
	*actual	e--estimated	r--revised	n.e.--not estimated	n.a.--not available	p--preliminary												

1/ The Budget of the United States Government, Fiscal Year 1979, January 1978.

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

3/ Includes Federal Financing Bank, Postal Service, U.S. Railway Association, Rural Electrification and Telephone Revolving fund, Housing for the Elderly or Handicapped Fund (until October 1977), and Pension Benefit Guaranty Corporation.

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

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

6/ Quarterly average exceeds fiscal year total by \$1.6 billion for FY 1977 and by \$1.7 billion for FY 1978 due to spreading of wage base effect over calendar year.

7/ Estimated by F.R.B. staff.

8/ Includes \$2.5 billion of borrowing from the Federal Reserve on September 30 which was repaid October 4.

Comments on the Fiscal Policy Outlook

The fiscal policy assumptions underlying the current GNP projection are little changed from a month ago. We continue to assume a \$25 billion tax package that consists of almost \$17 billion in net individual tax reductions, around \$6 billion in net business tax cuts, and \$1 billion each in telephone excise and unemployment insurance reductions.

Although our tax assumptions remain unchanged, the receipts forecast has been revised upward \$5 billion to \$398 billion, mainly due to re-estimates of withheld tax rates and tax refunds. This revenue forecast is about \$2 billion below the Administration's latest estimate; assumptions regarding income growth account for most of the difference. Outlays for the current fiscal year now are forecast at \$458.5 billion, up \$2 billion from last month's projection. Payments to farmers during the month of December exceeded previous expectations and are responsible for most of the upward revision.^{1/}

The staff expenditure and revenue estimates suggest a unified deficit in fiscal year 1978 of slightly more than \$60 billion and a total deficit (unified plus off-budget) to be financed of almost \$71 billion. About \$21 billion of this was met through borrowing in the fourth quarter.

^{1/} On an NIA basis the spending forecast is somewhat weaker than was presented last month. The difference between spending on the unified budget basis and the NIA basis for fiscal 1978 has narrowed considerably from earlier forecasts, because of Administration re-estimates of financial transactions and defense deliveries. A given unified outlay total, therefore, now translates into a lower level of NIA spending.

The Treasury raised \$11 billion through the sale of marketable debt thus far in the first quarter and the staff estimates that additional new financing of \$16 to \$17 billion will be required to carry the Treasury to the April 15 tax date. Between mid-April and the end of June, however, tax receipts are expected to be seasonally high, and the Treasury should be able to pay down marketable debt by around \$10 billion.

Fiscal year 1979 outlays are projected at just slightly over \$500 billion, about in line with the Administration's recent estimate. Our spending forecasts, however, do differ somewhat in composition from the Administration's. The current Greenbook forecast includes higher outlays for farm aid and for interests.^{2/} In addition, the spending forecast assumes Congressional inaction on some proposed budget reductions. These additions to outlays are partially offset by anticipated spending shortfalls from budgeted totals in a number of grant and transfer categories. Receipts, during fiscal 1979, are projected at \$436.5 billion, and the resulting deficit is nearly \$64 billion.

The current forecast--with its October 1, 1978 tax reductions--continues to show the high employment deficit increasing from \$12 billion in 1978:3 to \$31 billion in 1978:4. During the first half of 1979, however, the increased receipts resulting from higher social security taxes and from the progressive nature of the tax system, more than offset the full impact of the \$25 billion tax package. As a consequence, the high employment deficit declines to \$16 billion by the end of the forecast period.

^{2/} The January budget assumed a constant 6.1 per cent bill rate for fiscal years 1978 and 1979.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Short- and intermediate-term interest rates have changed little on balance since the last FOMC meeting. But with market rates continuing to exceed ceiling rates on most categories of time and savings deposits at banks and thrifts, an increasing volume of funds has apparently been diverted from depository institutions to market instruments. For example, noncompetitive tenders in Treasury auctions have risen somewhat, and following steady small rises in the fourth quarter, shares in money market mutual funds increased sharply further in January. As a result, after a sizable increase in the first week of the new year reflecting interest crediting, time and savings deposits subject to Regulation Q ceilings at banks continued to expand at a sluggish pace in January and early February. Moreover, thrift deposits have grown at steadily declining rates since last fall. In January, combined time and savings deposit growth at S&Ls and MSBs is estimated to be at about a 4-3/4 per cent seasonally adjusted annual rate, the slowest monthly growth of these deposits since the summer of 1974.

Despite the deceleration in the growth of small denomination time and savings deposits, bank and thrift loans have apparently continued to advance at a rapid rate. In recent months banks have run off a substantial volume of Treasury securities and have greatly increased issuance of large denomination time deposits not subject to Regulation Q ceiling rates. S&Ls, on the other hand, with only limited access to the

large time deposit market, have increased their borrowings from the FHLBanks and from other sources, principally commercial banks.

However, in the face of declining deposit flows and recourse by lending institutions to higher cost sources of funds, conditions in mortgage markets have begun to tighten. Although outstanding commitments at S&Ls edged upward further in December, new commitments were substantially smaller than in recent months. Moreover, interest rates on new commitments for conventional mortgages at S&Ls have increased 15 basis points since the first of the year. And applications for FHA/VA mortgage credit have apparently begun to decline in reflection of the deeper discounts--up to 5 points--now required by mortgage originators on loans bearing the maximum 8-1/2 per cent contract rate.

Outstanding consumer credit expanded sharply further in December. Reflecting the large volume of mortgage and consumer borrowing in 1977, the ratio of total household debt to disposable income has risen over the year and now stands at a level comparable to that of 1973 and 1974. Moreover, the ratio of the sum of outstanding mortgage and consumer credit to disposable income has increased steadily in recent months. Still, traditional indicators of financial distress generally remain favorable. Personal bankruptcies turned down near the end of last quarter and delinquency rates for most types of bank instalment loans and for finance company auto loans have been about unchanged for the last year.

In part because of a sharp reduction in long-term borrowing by financial firms following the backup in bond rates early in the year, total public corporate bond offerings in January were even smaller than the modest seasonally depressed volume marketed in December. On the other hand, the total volume of tax-exempt debt marketed in January remained large, although advance refunding issues declined sharply.

Shorter-term business borrowing has remained strong. For the December-January period business lending by banks was maintained at a rapid pace, with smaller banks increasing their outstanding business loans at an especially strong rate. During 1977 the ratio of short- to long-term corporate debt raised in markets has edged steadily upward, but remains well below the record level established in late 1974. Aggregate corporate liquidity, moreover, apparently remains comfortable and market receptivity to lower-rated issues--as measured by the interest rate spread between low- and higher-rated concerns--continues favorable.

The Treasury has borrowed a substantial volume of funds in the coupon market since year end. Early in the year foreign official institutions continued to purchase large quantities of Treasury securities, but such purchases have diminished markedly in recent weeks. Federal agency borrowing--at \$1.8 billion was much larger in January than a year ago. The largest share of agency borrowing was carried out by the FHLB System, as advances to S&Ls rose further in January.

Outlook. With aggregate credit demands in private short-term markets expected to remain at about their fourth quarter level, interest rates may fluctuate narrowly into early spring. Long-term corporate borrowing is expected to remain relatively light and sizable supplies of funds should continue to be provided to this market by institutional investors. Reflecting the slow pace of auto sales, more moderate expansion in other retail sales, and further increases in scheduled debt liquidation, growth in outstanding consumer credit could slow slightly in the current quarter; short-term business borrowing is expected to remain near that of the previous three months. Treasury borrowing is projected to accelerate substantially before the April 15 tax date, but this appears to have been discounted to a great extent by the market.

Even if market rates stabilize over the next month or two, mortgage market conditions may tighten somewhat further, as net deposit flows at thrifts with current ceiling rates remain relatively modest. Reduced spreads between yields on mortgages and bonds will tend to limit potential market support by large diversified lenders. And uncertainty regarding increases in the borrowing authority of FNMA could also contribute to tighter mortgage market conditions.

Any stabilization in market rates over the near-term is likely to prove temporary, given the projected strength of the economy and assuming a tax cut in the fall. As the year progresses, continued strong demands for money and credit are likely to lead to further increases in short- and also, to a degree, in longer-term market rates.

INTERNATIONAL DEVELOPMENTS

Summary. Pressure on the dollar -- at times heavy -- resumed during the past two weeks, following the relatively calm period for the dollar on exchange markets of the previous month. Prospects for large U.S. current-account deficits continuing into the indefinite future, as well as uncertainty about the course of U.S. economic policies, were factors that contributed to the downward pressure on the dollar.

Over the six-week period since the previous green book, the weighted-average exchange rate for the dollar declined a further 1.2 per cent, bringing to about 7 per cent the total depreciation since the end of September.

. During the past six weeks the System and the Treasury each sold more than \$350 million equivalent of German marks, and the System also sold nearly \$70 million equivalent of Swiss francs. Most of this activity has occurred during the past week and a half.

Since last month's green book, all major currencies except the French franc and Canadian dollar have appreciated against the dollar, with the Swiss franc (about 9 per cent) and the mark (less than 4 per cent) appreciating the most. The further appreciation of the mark intensified pressure within the EC joint float, and on February 10 Norway devalued

its currency against its snake partners by 8 per cent. The French franc has fallen by more than 2 per cent against the dollar since the beginning of February, reflecting market concern about the mid-March French parliamentary elections, with latest polls continuing to give the Socialist and Communist parties combined a slight edge. The renewed weakening of the Canadian dollar, which fell by more than 1 per cent over the past six weeks, continues to be associated with internal Canadian political uncertainties.

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The U.S. trade balance in December continued to reflect the effects of last fall's dock strike. For the final quarter of last year, the trade deficit was \$35.5 billion at an annual rate, a figure that was enlarged by the lingering effects of the dock strike.

Foreign official assets in the United States (excluding OPEC holdings) increased by \$3.5 billion in December. The total net foreign official inflow for the fourth quarter exceeded \$14 billion, nearly half of the total of such inflows for the year as a whole.

. Assets

of OPEC official accounts in the United States decreased by \$700 million in December. In 1977, OPEC holdings in the United States increased by \$6 billion, a rate about \$1 billion lower than a year earlier.

Bank-reported private capital transactions (adjusted for reporting bias) showed a net outflow of \$600 million in December,

bringing the total net (adjusted) outflow for the final quarter of last year to \$2.3 billion. For 1977 as a whole, the net outflow amounted to nearly \$2 billion, far below the \$10 billion net outflow recorded in 1976.

Total new borrowing on international capital markets (Euro-credit, Euro-bond, and foreign bond markets) in the fourth quarter of 1977 exceeded \$15 billion, the same rate as in the previous quarter. For 1977, total new borrowing in these markets amounted to about \$62.5 billion, about equal to the amount borrowed in 1976. Euro-bond issues increased substantially last year, while Euro-credits rose little and foreign bond issues declined. Borrowing in the Euro-credit market by non-oil developing countries declined slightly last year, but this was more than offset by increased borrowing by these countries in the Euro-bond market.

Outlook. Latest data suggest that growth of output in several foreign countries recovered somewhat in the final quarter of last year. Industrial production recorded a substantial quarter-to-quarter rise in Japan, and more moderate rises were recorded by Germany and Canada, following two quarters of flat output in these three countries. The staff projects a moderate growth of activity abroad this year, led primarily by increased consumption and government spending. For the six major foreign countries combined, the staff projects an acceleration of expansion to a year-over-year rate of about 4 per cent (compared with

a rate of less than 3 per cent last year), and a fourth-quarter-to-fourth-quarter rate of about 4.5 per cent.

The latest staff projection for the U.S. trade and current accounts this year and for the first half of next year indicate slightly larger deficits than those presented last month. A \$33 billion trade deficit is expected this year, with the rate leveling off at about \$36 billion beginning this summer. The rate of merchandise exports in 1978 has been reduced somewhat, though they are projected to increase by 12 per cent over last year. The current-account deficit for this year is now projected at \$21 billion, with expectations of a leveling off at about \$22-23 billion starting in the second half of the year.

Particularly in view of the considerable depreciation of the dollar since the end of September, the staff expects no significant further change for the average value of the dollar in the year ahead. However, given the projections for continuing large U.S. trade and current-account deficits and remaining uncertainties about U.S. economic policies, exchange rates for the dollar may continue to be subject to wide fluctuations during the year. Some further appreciation of the mark and yen is expected to occur over this period.

	1976	1977 ^P	1978 ^P	1977				1978 ^P				1979 ^P	
				I	II	III	IV ^P	I	II	III	IV	I	II
1. <u>GNP NET EXPORTS</u> - Intl Acct. data	7.7	-9.0	-8.5	-7.6	-9.1	-6.9	-12.5	-5.2	-8.9	-9.9	-9.9	-9.1	-8.4
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(7.8)	(-10.1*)	(-11.1)	(-8.2*)	(-9.7*)	(-7.5*)	(-15.1*)	(-7.8)	(-11.5)	(-12.5)	(12.5)	(-11.7)	(-11.0)
3. a) Merchandise Trade Balance	-9.3	-31.4*	-33.2	-28.6	-31.2	-30.2	-35.5*	-29.1	-33.2	-35.1	-35.7	-36.0	-35.7
4. Exports (excl. military)	114.7	120.4	135.1	117.8	122.4	123.5	118.0*	129.0	132.2	137.2	142.1	147.1	152.0
5. Agricultural	23.4	24.3	23.0	24.4	26.7	24.0	22.2*	23.1	22.8	23.0	23.2	23.4	23.6
6. Nonagricultural	91.3	96.1	112.1	93.4	95.6	99.4	95.8*	105.9	109.4	114.2	118.9	123.7	128.4
7. Imports	124.0	151.8	168.3	146.4	153.6	153.7	153.5*	158.1	165.4	172.3	177.8	183.1	187.7
8. Petroleum and petrol. products	34.6	44.8	46.1	44.1	47.7	45.8	41.5*	42.1	45.2	47.9	49.4	50.9	51.2
9. Nonpetroleum	89.4	107.0	122.2	102.4	105.9	107.9	112.0*	116.0	120.2	124.4	128.4	132.2	136.5
10. b) Military transactions, net <u>2/</u>	--	1.6	2.0	1.7	.8	1.9	1.8	2.0	2.0	2.0	2.0	2.0	2.0
11. c) Investment income, net <u>3/</u>	14.3	18.5	20.2	17.9	19.1	18.4	18.5	19.6	19.9	20.5	20.8	21.8	22.2
12. d) Other services, net <u>4/</u>	2.7	2.3	2.6	1.4	2.1	3.1	2.7	2.3	2.4	2.7	3.0	3.1	3.1
13. <u>U.S. CURRENT ACCOUNT BALANCE</u>	-1.4	-19.1	-21.0	-16.9	-18.6	-17.4	-23.5	-17.2	-21.5	-22.6	-23.0	-23.0	-22.5
14. a) GNP net exports (line 1.)	7.7	-9.0	-9.5	-7.6	-9.1	-6.9	-12.5	-5.2	-8.9	-9.9	-9.9	-9.1	-8.4
15. b) U.S. Govt & private transfers <u>5/</u>	-9.1	-10.1	-11.5	-9.3	-9.5	-10.5	-11.0	-12.0	-12.6	-12.7	-13.1	-13.9	-14.1
<u>Constant (1972) dollars</u>													
16. Merchandise exports (excl. military)	66.7	66.9	71.9	66.1	67.6	68.7	65.0	70.6	71.0	72.4	73.7	75.0	76.3
17. (% change, annual rates)	(3.4)	(0.2)	(7.5)	(-7.4)	(9.5)	(6.1)	(-22.9)	(39.1)	(2.0)	(8.2)	(7.4)	(7.4)	(7.0)
18. Merchandise imports	62.8	71.1	74.5	70.3	72.0	71.2	70.8	71.7	73.8	75.5	72.0	77.9	78.5
19. (% change, annual rates)	(22.5)	(13.2)	(4.8)	(28.2)	(10.0)	(-4.5)	(-2.0)	(4.9)	(12.1)	(10.0)	(7.8)	(4.9)	(2.8)
<u>Foreign Outlook - Major Industrial Countries <u>6/</u></u>													
20. Real GNP, % change, annual rates	5.2	2.8	3.8	5.7	0.4	1.2	4.1	4.9	4.9	4.1	4.5	4.5	4.5
21. Wholesale Prices, % change, A.R. <u>7/</u>	9.4	8.7	5.1	10.4	7.4	3.7	3.3	5.3	6.1	6.1	6.1	5.7	5.7

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

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

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

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

5/ Includes U.S. Govt. grants, U.S. Govt. interest payments to foreigners, remittances and pensions, and exports to Israel financed by U.S. military assistance grants.

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

7/ Data are largely manufactured goods prices.

P/ Projected

* Estimated

† Published data.