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CONFIDENTIAL (FR)

December 13, 1978

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Employment and production expanded substantially in November and retail sales rose vigorously. In the investment area, indicators of near-term capital spending remained strong, but surveys of anticipated capital spending suggest a considerable slowing of growth in 1979. Housing starts remained high in October and sales of both new and existing units rose strongly. Prices continued to move upward rapidly at both the producer and consumer levels.

The large employment rise in November--for the second consecutive month--was about matched by the labor force increase, and the unemployment rate was unchanged at 5.8 per cent. Widespread gains in employment were spearheaded by a brisk rise in manufacturing, and the workweek rose as well. Given these and other data, industrial production is tentatively estimated to have increased about 3/4 percentage point in November.

Total retail sales rose strongly in November--by 2 per cent--following a substantial (upward revised) October gain. Gains were widespread in November with an especially large advance at general merchandise stores. However, total unit auto sales moved down, as sales of domestic models fell about 1/2 million units annual rate from October to an 8.8 million unit rate in November. Sales of foreign cars edged up fractionally.

In the business investment area, new orders for nondefense capital goods jumped by 10 per cent in October, with machinery orders, which had been on a plateau earlier this year, increasing sharply for the second successive month. In light of the rise in new orders for nondefense capital goods and with shipments down marginally, unfilled orders for such goods rose 4 per cent over the month to a record \$102 billion. The value of construction contracts increased further in October; during the last three months such contracts averaged nearly one fourth above a year earlier.

At the same time, the Commerce Department November survey suggested that growth of plant and equipment expenditures over the first half of 1979 would decelerate to an 8 per cent annual rate in nominal terms, following a 14 per cent rate rise in the second half of this year. Private surveys of anticipations and recent data on newly approved capital appropriations in the manufacturing sector appear to be generally consistent with the Commerce findings.

Inventory investment has continued to reflect cautious business attitudes. The book-value of manufacturers' stocks rose at an annual rate of \$11-1/2 billion in October--the smallest monthly rise so far this year. Shipments rose sharply, and the ratio of inventories to sales for all manufacturers declined to a near-record low. However, there has been a substantial accumulation of stocks by general merchandise stores over recent months; by September their over-all book value inventory/sales ratio had risen to a record high. However,

inventory problem in this sector should be rectified to some extent by the surge in retail sales in November.

The latest housing market data (for October) showed considerable strength. Housing starts were at an annual rate of 2.1 million units and sales of single-family homes rose to a new high. Since October, however, mortgage markets have tightened further and there have been increasing reports of retrenchment in this sector.

State and local government employment increased considerably in November but remained below its August level, perhaps reflecting a cutback in public service employment programs apparently in anticipation of reduced Federal funding for these programs. State and local construction expenditures remained strong through October, the latest month for which such data are available.

The Consumer Price Index, led by food, energy, and homeownership costs, rose at close to a 9 per cent annual rate in October for the second successive month. Producer prices of finished goods increased at a similar rate in November for the third straight month. The rise in wholesale food prices moderated at all stages of processing in November, but increases still remained large. The increase in nonfood finished goods prices accelerated, due partially to a sharp rise in capital equipment prices. In addition, prices of construction materials rose further, led by increases for lumber and plywood.

Outlook. Real GNP is now expected to grow at almost a 4-1/2 per cent annual rate in the current quarter, a percentage point above the third quarter pace. Consumer demand and business capital spending have been the key sources of strength recently. A further decline is evident in residential construction activity, although housing starts appear slightly stronger than previously projected. Fourth quarter price increases are estimated to be at an 8 per cent annual rate, three quarters of a point higher than last month's indication, in part because of the faster rise in prices of some energy items.

The monetary policy assumptions underlying the present staff projection remain essentially the same as a month ago and are consistent with the midpoints of the Federal funds rate ranges shown for alternative A in the Bluebook. M-1 growth through the end of 1979 is assumed to be equivalent to a slightly more than 6 per cent rate when the impact of ATS is removed. M-2 growth is assumed to be near the mid-point of its 6-1/2 to 9 per cent longer-run range. Short-term interest rates are projected to remain near their current levels. The fiscal policy assumptions are basically unchanged through the end of the current fiscal year. The staff estimate of Federal outlays in FY 1979 remains at \$491 billion, and total receipts are projected at \$452 billion.

Over the four quarters of 1979, growth of real GNP is projected to be about 2 per cent, the same as last month's estimate. Real growth is expected to average about 2-3/4 per cent annual rate in the first half of 1979, but then to slow to a 1-1/2 per cent pace in the second half.

Growth of investment demand is projected to weaken over the course of next year and the concomitant deceleration of income gains would tend to dampen growth in other sectors. Even after taking account of the recent surge in new orders for capital goods, real business fixed investment is projected to rise only about 2-1/4 per cent in 1979. The forecasted decline in residential construction outlays, although more moderate than in previous housing cycles, is expected to continue throughout next year as housing starts decline to about a 1.6 million unit annual rate by the fourth quarter. With income flows dampened and personal saving rates already well below historical averages, growth of consumer spending is expected to slow considerably in 1979, especially as the effect of the January 1 tax cut dissipates. In line with the moderation in the rate of economic expansion, employment growth is projected to slow and the unemployment rate appears likely to rise to about 6-1/2 per cent by year-end.

The staff's projection of inflation during 1979 has been increased from last month's forecast. The fixed-weighted price index for gross business product is projected to move up about 7-3/4 per cent over the year--about 1 percentage point less than the rise this year. Price increases are likely to be particularly rapid the first part of 1979 due, in part, to the initial effects of legislated labor cost increases and to the effects of an assumed 7-1/2 per cent OPEC oil

price hike effective January 1. However, the Administration's anti-inflation guidelines and the effect of reduced growth in aggregate demand are assumed to exert some moderating influence on price and wage increases as the year progresses.

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

STAFF GNP PROJECTIONS

	Per cent changes, annual rate							
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	11/15/78	12/13/78	11/15/78	12/13/78	11/15/78	12/13/78	11/15/78	12/13/78
1975 1/	8.2	8.2	-1.3	-1.3	9.4	9.4	8.5	8.5
1976 1/	11.2	11.2	5.7	5.7	5.4	5.4	7.7	7.7
1977 1/	11.0	11.0	4.9	4.9	6.2	6.2	7.0	7.0
1978	11.5	11.7	3.9	3.9	7.5	7.8	6.0	6.0
1979	10.8	11.4	3.1	3.3	7.8	8.2	6.1	6.1
1978-I 1/	7.1	7.1	-1	-1	6.7	6.7	6.2	6.2
1978-II 1/	20.6	20.6	8.7	8.7	12.1	12.1	5.9	5.9
1978-III 1/	10.7	10.7	3.4	3.4	7.5	8.2	6.0	6.0
1978-IV	11.2	12.9	3.3	4.4	7.3	8.0	5.9	5.8
1979-I	11.3	12.1	3.4	3.7	7.9	8.3	5.9	5.8
1979-II	9.5	9.3	2.3	2.0	7.9	8.1	6.0	6.0
1979-III	8.4	8.5	1.6	1.5	7.0	7.3	6.2	6.2
1979-IV	8.9	8.9	1.4	1.2	7.1	7.3	6.4	6.4
Change:								
77-II to								
78-II	11.8	11.8	4.3	4.3	7.5	7.5	-1.2	-1.2
77-IV to								
78-IV	12.3	12.7	3.8	4.1	8.4	8.8	-.7	-.8
78-II to								
79-II	10.6	11.2	3.1	3.4	7.6	8.2	.1	.1
78-IV to								
79-IV	9.5	9.7	2.1	2.1	7.4	7.8	.5	.6
Memo:								
Growth Over Annual Policy Period:								
78-III to								
79-III	10.1	10.7	2.6	2.9	7.5	7.9	.2	.2

1/ Actual.

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CLASS II FOMC

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

	1978				1979			
	I	II	III	IV	Projected			
					I	II	III	IV
Gross national product	1992.0	2087.5	2141.4	2207.4	2271.1	2322.2	2370.3	2421.5
Final purchases	1975.3	2067.4	2127.6	2193.6	2256.3	2307.4	2356.5	2408.7
Private	1558.6	1642.7	1688.0	1741.0	1794.1	1835.9	1875.2	1914.4
Excluding net exports	1582.7	1648.2	1694.6	1746.5	1794.1	1836.0	1870.7	1906.8
Personal consumption expenditures	1276.7	1322.9	1357.7	1400.5	1439.6	1477.6	1509.2	1540.1
Goods	684.9	717.1	731.4	758.8	779.8	798.6	813.2	827.4
Services	591.8	605.8	626.3	641.7	659.8	679.0	696.0	712.7
Gross private domestic investment	322.7	345.4	350.6	359.8	369.3	373.2	375.3	379.5
Residential construction	100.3	105.3	108.9	111.4	113.1	111.1	108.7	108.5
Business fixed investment	205.6	220.1	227.9	234.6	241.4	247.3	252.8	258.2
Change in business inventories	16.7	20.1	13.8	13.8	14.8	14.8	13.8	12.8
Nonfarm	16.9	22.1	14.8	13.8	14.8	14.8	13.8	12.8
Net exports of goods and services ^{1/}	-24.1	-5.5	-6.6	-5.5	.0	-.1	4.5	7.6
Exports	181.7	205.4	213.8	224.3	234.0	242.3	250.5	258.4
Imports	205.8	210.9	220.3	229.7	233.9	242.3	245.9	250.7
Gov't. purchases of goods and services	416.7	424.7	439.6	452.6	462.2	471.5	481.3	494.3
Federal ^{2/}	151.5	147.2	154.0	161.0	163.7	166.2	169.3	175.6
State and local	265.2	277.6	285.6	291.6	298.5	305.3	312.0	318.7
Gross national product in constant (1972) dollars	1354.2	1382.6	1394.2	1409.4	1422.2	1429.1	1434.4	1438.8
Personal income	1628.9	1682.4	1730.6	1785.4	1829.3	1873.1	1920.9	1963.4
Wage and salary disbursements	1050.8	1090.2	1113.0	1148.8	1179.4	1204.8	1229.5	1257.4
Disposable personal income	1391.6	1433.3	1467.5	1510.8	1558.1	1594.1	1633.6	1668.0
Saving rate (per cent)	5.9	5.3	5.1	4.9	5.2	4.9	5.2	5.2
Corporate profits with I.V.A. and C.C. Adj.	132.6	163.4	168.4	172.5	174.2	178.3	181.7	186.1
Corporate profits before tax	172.1	205.5	208.6	214.3	215.9	220.0	223.2	227.4
Federal government surplus or deficit (-) (N.I.A. basis)	-52.6	-23.6	-22.6	-22.7	-26.1	-25.2	-29.6	-32.2
High employment surplus or deficit (-)	-2.9	17.5	22.3	13.1	13.6	19.8	20.8	23.0
State and local government surplus or deficit (-) (N.I.A. basis)	31.5	29.8	23.7	25.3	24.9	24.0	22.3	22.9
Excluding social insurance funds	11.5	9.3	2.1	3.1	2.1	.6	-1.7	-2.1
Civilian labor force (millions)	99.2	100.2	100.7	101.5	102.1	102.8	103.3	103.7
Unemployment rate (per cent)	6.2	5.9	6.0	5.8	5.8	6.0	6.2	6.4
Nonfarm payroll employment (millions)	84.3	85.7	86.1	87.0	87.4	87.8	88.0	88.3
Manufacturing	20.1	20.3	20.3	20.6	20.7	20.8	20.9	20.9
Industrial production (1967=100)	139.6	144.0	146.9	149.2	151.1	152.3	153.1	153.8
Capacity utilization: all mfg. (per cent)	82.1	84.0	84.9	85.7	85.9	85.8	85.5	85.0
Materials (per cent)	81.7	84.5	86.0	86.8	87.3	87.3	87.1	86.7
Housing starts, private (million units, A.R.)	1.72	2.11	2.08	2.00	1.85	1.75	1.65	1.60
New autos sales, (millions, A.R.)	10.80	12.12	11.16	11.05	10.75	10.60	10.45	10.30
Domestic models	8.80	10.01	9.19	9.00	8.90	8.85	8.80	8.75
Foreign models	2.00	2.11	1.98	2.05	1.85	1.75	1.65	1.55

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

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

December 13, 1978

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

	1978				1979			
	I	II	III	IV	Projected			
	I	II	III	IV	I	II	III	IV
<u>Constant (1972) dollars</u>								
Gross national product	-.1	8.7	3.4	4.4	3.7	2.0	1.5	1.2
Final purchases	-1.6	8.6	4.5	4.6	3.5	2.0	1.7	1.4
Private	-1.1	11.0	3.8	5.0	3.9	1.9	1.5	1.2
Excluding net exports	-1.0	7.7	3.9	4.6	2.8	1.9	.7	.7
Personal consumption expenditures	-1.4	6.0	4.2	5.2	3.2	3.0	1.7	1.2
Goods	-8.1	9.7	2.7	8.1	3.4	2.3	.9	.5
Services	7.0	1.9	6.1	1.9	3.1	3.8	2.7	2.3
Gross private domestic investment	11.3	15.2	-4.3	1.2	2.2	-2.9	-4.8	-2.8
Residential structures	-5.2	2.7	-1.5	-3.9	-5.6	-15.4	-16.7	-9.8
Business fixed investment	4.2	21.3	4.2	4.7	3.8	2.2	1.5	1.2
Gov't. purchases of goods and services	-3.5	-.2	7.1	2.9	2.1	2.1	2.5	2.2
Federal	-8.9	-15.3	14.4	5.6	1.6	1.9	3.2	2.6
State and local	-.1	9.6	3.2	1.4	2.4	2.3	2.0	1.9
Disposable personal income	1.1	3.5	3.3	4.3	4.6	1.7	3.1	1.5
<u>Current dollars</u>								
Gross national product	7.1	20.6	10.7	12.9	12.1	9.3	8.5	8.9
Final purchases	6.4	20.0	12.1	13.0	11.9	9.4	8.8	9.2
Private	7.0	23.4	11.5	13.2	12.8	9.6	8.8	8.6
Excluding net exports	7.1	17.6	11.7	12.8	11.4	9.7	7.8	7.9
Personal consumption expenditures	7.0	15.3	11.0	13.2	11.6	11.0	8.8	8.4
Goods	.5	20.2	8.2	15.8	11.5	10.0	7.5	7.2
Services	15.3	9.8	14.2	10.2	11.8	12.2	10.4	9.9
Gross private domestic investment	12.2	31.3	6.2	10.9	11.0	4.3	2.3	4.6
Residential structures	.5	21.0	14.7	9.5	6.2	-6.9	-8.4	-.7
Business fixed investment	11.1	31.2	15.0	12.3	12.1	10.1	9.2	8.8
Gov't. purchases of goods and services	4.1	7.9	14.8	12.4	8.8	8.3	8.6	11.2
Federal	-2.0	-10.9	20.1	19.5	6.9	6.2	7.7	15.7
State and local	7.8	19.9	12.4	8.7	9.8	9.4	9.1	8.9
Disposable personal income	9.8	12.5	9.9	12.3	13.1	9.6	10.3	8.7
Personal income	9.3	13.8	12.0	13.3	10.2	9.9	10.6	9.2
Wage and salary disbursements	12.1	15.9	8.6	13.5	11.1	8.9	8.5	9.4
Corporate profits with IVA & C.C. Adj.	-35.9	130.6	12.8	10.1	4.0	9.8	7.8	10.0
Corporate profits before tax	-13.2	103.3	6.2	11.4	3.2	7.6	6.0	7.7
Nonfarm payroll employment	3.8	6.9	2.1	4.0	2.0	1.8	1.3	1.2
Manufacturing	5.7	3.1	-.2	5.6	2.6	2.2	1.6	.8
Nonfarm business sector								
Output per hour	-3.1	1.7	2.3	.0	2.0	.9	.6	.6
Compensation per hour	12.2	8.2	9.5	8.8	12.3	8.6	8.6	8.5
Unit labor costs	15.7	6.4	7.1	8.8	10.1	7.6	8.0	7.9
GNP implicit deflator ^{1/}	7.2	11.0	7.1	8.1	8.1	7.2	7.0	7.6
Gross business product fixed-weighted price index ^{2/}	6.7	12.1	8.2	8.0	8.3	8.1	7.3	7.3
Industrial production	.9	13.2	8.3	6.4	5.1	3.3	2.2	1.7

^{1/} Excluding Federal pay increase rates of change are: 1978 QI, 7.2 per cent; 1978 QIV, 7.5 per cent; 1979 QI, 8.0 per cent; 1979 QIV, 7.1 per cent.

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

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

	1972	1973	1974	1975	1976	1977	Projected	
							1978	1979
Gross national product	1171.1	1306.6	1412.9	1528.8	1700.1	1887.2	2107.1	2346.3
Final purchases	1161.7	1288.6	1404.0	1539.6	1689.9	1871.6	2091.0	2332.3
Private	908.6	1019.1	1101.3	1201.2	1330.4	1477.6	1657.6	1854.9
Excluding net exports	911.9	1012.0	1095.3	1180.8	1323.0	1488.7	1668.0	1851.9
Personal consumption expenditures	733.0	809.9	889.6	979.1	1090.2	1206.5	1339.4	1491.6
Goods	410.5	457.5	498.3	541.5	599.2	657.4	723.0	804.7
Services	322.4	352.3	391.3	437.5	491.0	549.2	616.4	686.9
Gross private domestic investment	188.3	220.0	214.6	190.9	243.0	297.8	344.6	374.3
Residential construction	62.0	66.1	55.1	51.5	68.2	91.9	106.5	110.3
Business fixed investment	116.8	136.0	150.6	150.2	164.6	190.4	222.1	249.9
Change in business inventories	9.4	17.9	8.9	-10.7	10.2	15.6	16.1	14.0
Nonfarm	8.8	14.7	10.8	-14.3	12.2	15.0	16.9	14.0
Net exports of goods and services ^{1/}	-3.3	7.1	6.0	20.4	7.4	-11.1	-10.4	3.0
Exports	72.7	101.6	137.9	147.3	163.2	175.5	206.3	246.3
Imports	75.9	94.4	131.9	126.9	155.7	186.6	216.7	243.2
Gov't. purchases of goods and services	253.1	269.5	302.7	338.4	359.5	394.0	433.4	477.3
Federal ^{2/}	102.1	102.2	111.1	123.1	129.9	145.1	153.4	168.7
State and local	151.0	167.3	191.5	215.4	229.6	248.9	280.0	308.6
Gross national product in constant (1972) dollars	1171.1	1235.0	1217.8	1202.3	1271.0	1332.7	1385.1	1431.1
Personal income	942.5	1052.4	1154.9	1255.5	1380.9	1529.0	1706.8	1896.7
Wage and salary disbursements	633.8	701.3	764.6	805.9	890.1	983.6	1100.7	1217.8
Disposable personal income	801.3	901.7	984.6	1086.7	1184.4	1303.0	1450.8	1613.4
Saving rate (per cent)	6.2	7.8	7.3	7.7	5.7	5.1	5.3	5.1
Corporate profits with I.V.A. and C.C. Adj.	92.1	99.1	83.6	95.9	127.0	144.2	159.2	180.1
Corporate profits before tax	96.2	115.8	126.9	120.4	155.9	173.9	200.1	221.6
Federal government surplus or deficit (N.I.A. basis)	-17.3	-6.7	-10.7	-70.6	-53.8	-48.1	-30.4	-28.3
High employment surplus or deficit (-)	-5.9	-7	17.1	-19.4	-9.3	-4.6	12.5	19.3
State and local government surplus or deficit (-) (N.I.A. basis)	13.7	13.0	7.6	6.2	20.7	29.6	27.6	23.5
Excluding social insurance funds	5.6	4.1	-2.9	-6.2	5.5	11.5	6.5	-3
Civilian labor force (millions)	86.5	88.7	91.0	92.6	94.8	97.4	100.4	103.0
Unemployment rate (per cent)	5.6	4.9	5.6	8.5	7.7	7.0	6.0	6.1
Nonfarm payroll employment (millions)	73.7	76.8	78.3	76.9	79.4	82.3	85.8	87.9
Manufacturing	19.2	20.2	20.1	18.3	19.0	19.6	20.3	20.8
Industrial production (1967=100)	119.7	129.8	129.3	117.8	129.8	137.1	144.9	152.6
Capacity utilization: all manufacturing (per cent)	83.1	87.5	84.2	73.6	80.2	82.5	84.1	85.6
Materials (per cent)	88.0	92.4	87.7	73.6	80.4	81.9	84.8	87.1
Housing starts, private (million units, A.R.)	2.36	2.05	1.34	1.16	1.54	1.99	1.98	1.71
New auto sales, (millions, A.R.)	10.93	11.42	8.91	8.66	10.12	11.13	11.28	10.52
Domestic models	9.32	9.65	7.49	7.08	8.63	9.07	9.25	8.82
Foreign models	1.61	1.77	1.42	1.58	1.50	2.06	2.03	1.70

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

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

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CLASS II FOMCPER CENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1972	1973	1974	1975	1976	1977	Projected	
							1978	1979
<u>Constant (1972) dollars</u>								
Gross national product	5.7	5.5	-1.4	-1.3	5.7	4.9	3.9	3.3
Final purchases	5.5	4.9	-.7	.2	4.3	4.7	3.8	3.5
Private	6.7	6.3	-1.4	-.3	5.5	5.3	4.3	3.7
Excluding net exports	7.0	5.1	-2.3	-1.0	6.4	6.0	4.3	3.0
Personal consumption expenditures	5.9	4.7	-.9	1.8	5.8	4.7	3.8	3.5
Goods	6.5	5.0	-3.4	.7	6.4	5.0	3.2	3.8
Services	5.3	4.4	2.3	3.2	5.0	4.4	4.6	3.2
Gross private domestic investment	12.9	10.0	-11.4	-22.3	21.6	13.2	7.1	-.2
Residential structures	18.8	-3.7	-24.6	-13.9	23.4	20.5	3.1	-7.8
Business fixed investment	8.1	12.2	-.3	-13.0	4.7	9.1	7.9	4.2
Gov't. purchases of goods and services	1.5	-.2	2.1	1.9	.1	2.4	2.1	2.8
Federal	-1.7	-5.4	-.8	.7	.1	5.2	-1.5	3.0
State and local	3.8	3.2	3.8	2.6	.1	.8	4.2	2.6
Disposable personal income	4.2	6.7	-1.5	2.1	3.5	4.1	4.1	3.4
<u>Current dollars</u>								
Gross national product	10.1	11.6	8.1	8.2	11.2	11.0	11.7	11.4
Final purchases	9.9	10.9	8.9	9.7	9.8	10.8	11.7	11.5
Private	10.3	12.2	8.1	9.1	10.8	11.1	12.2	11.9
Excluding net exports	11.0	11.0	8.2	7.8	12.0	12.5	12.0	11.0
Personal consumption expenditures	9.7	10.5	9.8	10.1	11.4	10.7	11.0	11.4
Goods	9.5	11.4	8.9	8.7	10.7	9.7	10.0	11.3
Services	9.9	9.3	11.1	11.8	12.2	11.8	12.2	11.4
Gross private domestic investment	17.7	16.8	-2.5	-11.0	27.3	22.6	15.7	8.6
Residential structures	25.0	6.6	-16.7	-6.5	32.5	34.8	15.9	3.6
Business fixed investment	12.2	16.4	10.8	-.3	9.6	15.7	16.6	12.5
Gov't. purchases of goods and services	8.3	6.5	12.3	11.8	6.2	9.6	10.0	10.1
Federal	6.1	.1	8.7	10.7	5.5	11.7	5.7	10.0
State and local	9.8	10.8	14.5	12.5	6.6	8.4	12.5	10.2
Disposable personal income	7.9	12.5	9.2	10.4	9.0	10.0	11.3	11.2
Personal income	9.7	11.7	9.7	8.7	10.0	10.7	11.6	11.1
Wage and salary disbursements	9.4	10.6	9.0	5.4	10.4	10.5	11.9	10.6
Corporate profits with IVA & C.C. Adj.	19.3	7.6	-15.6	14.7	32.4	13.5	10.4	13.1
Corporate profits before tax	17.3	20.4	9.6	-5.1	29.5	11.5	15.1	10.7
Nonfarm payroll employment	3.5	4.3	1.9	-1.7	3.2	3.6	4.3	2.5
Manufacturing	3.1	5.2	-.4	-8.7	3.7	3.4	3.4	2.5
Nonfarm business sector								
Output per hour	3.0	1.7	-2.9	1.9	3.6	1.3	.3	1.1
Compensation per hour	5.8	7.8	9.4	9.9	8.5	8.1	9.2	9.6
Unit labor costs	2.7	6.0	12.7	7.9	4.7	6.7	8.9	8.4
GNP implicit deflator	4.1	5.9	9.7	9.6	5.2	5.9	7.4	7.8
Gross business product fixed-weighted price index ^{1/}	3.3	5.7	10.4	9.4	5.4	6.2	7.8	8.2
Industrial production	9.2	8.4	-.4	-8.9	10.2	5.6	5.7	5.3

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

	Fiscal Year 1978*	FY 1979 e/				CY78 e/		CY79 e/		F.R.B. staff estimates							
		Admin. 1/	F.R. Board		Cong. 2/	F.R. Board		Calendar quarters; unad-				justed data					
			F.R. Board			F.R. Board		1978				1979					
								I*	II*	III*	IV	I	II	III	IV		
Unified budget receipts 3/	402.0	452.7	452.3	448.7	416.4	458.3	85.4	125.3	106.8	99.0	99.5	137.2	116.6	104.9			
Unified budget outlays 3/	450.8	491.6	491.0	487.5	460.7	500.2	111.2	111.3	114.9	123.3	121.3	122.6	123.8	132.5			
Surplus(+)/Deficit(-), unified budget	-48.8	-38.9	-38.7	-38.8	-44.3	-41.9	-25.8	14.0	-8.1	-24.3	-21.8	14.6	-7.2	-27.6			
Surplus(+)/Deficit(-), off-budget agencies 4/	-10.3	-12.9	-10.7	n.a.	-9.8	-11.2	-3.6	-2.3	-3.1	-0.8	-3.3	-3.8	-2.8	-1.3			
Means of financing combined deficits:																	
Net borrowing from public	59.1	n.a.	39.2	n.a.	53.4	51.6	20.8	2.5	15.1	15.0	16.3	-5.3	13.2	27.4			
Decrease in cash operating balance	-3.3	n.a.	10.4	n.a.	-0.8	1.1	5.9	-11.1	-4.9	9.3	5.1	-4.0	0	0			
Other 5/	3.2	n.a.	-0.3	n.a.	1.3	0.5	2.8	-3.2	1.0	0.7	3.7	-1.5	-3.2	1.5			
Cash operating balance, end of period	22.4	n.a.	12.0	n.a.	13.1	12.0	6.4	17.5	22.4	13.1	8.0	12.0	12.0	12.0			
Memo: Sponsored agency borrowing 6/	19.1	n.a.	18.9	n.a.	22.3	16.7	4.5	6.5	6.1	5.2	3.5	5.2	5.0	3.0			
NIA Budget							Seasonally adjusted annual rates										
Receipts	411.8 ^{8/}	n.a.	467.0 ^{8/}	n.a.	430.1	478.4	396.2	424.8	441.9	457.4	462.0	472.3	483.9	495.6			
Expenditures	451.4	495.6	494.8	n.a.	460.4	506.7	448.8	448.3	464.5	480.1	488.1	497.5	513.5	527.8			
Purchases (total)	151.3	166.8	165.1	n.a.	153.4	168.7	151.5	147.2	154.0	161.0	163.7	166.2	169.3	175.6			
Defense	98.3	104.7	104.8	n.a.	99.8	106.9	97.9	98.6	99.8	102.7	103.8	105.6	107.2	110.8			
Non-defense	52.9	62.1	60.3	n.a.	53.6	61.8	53.6	48.6	54.3	58.3	59.9	60.6	62.1	64.8			
All other expenditures	300.1 ^{8/}	328.8	329.7 ^{8/}	n.a.	307.0	338.0	297.3	301.1	310.5	319.1	324.4	331.3	344.2	352.2			
Surplus(+)/Deficit(-)	-39.6 ^{8/}	n.a.	-27.8 ^{8/}	n.a.	-30.3	-28.3	-52.6	-23.5	-22.6	-22.7	-26.1	-25.2	-29.6	-32.2			
High Employment Surplus(+)/Deficit(-) (NIA basis) 7/	5.2	n.a.	16.8	n.a.	12.5	19.3	-2.9	17.5	22.3	13.1	13.6	19.8	20.8	23.0			

* actual e--estimated r--revised n.a.--not available

1/ OMB October Budget Update (October 27, 1978), Mid-Session Review of the 1979 Budget (July 6, 1978) and the Department of Commerce.

2/ Second Concurrent Budget Resolution (September 20, 1978).

3/ Adjusted for accounting change in earned income credit payments--formerly treated as income tax refunds and now classified as outlays.

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

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

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

7/ FRB staff estimates.

8/ Quarterly average exceeds fiscal year total by \$1.0 billion for fiscal year 1978, and by \$3.5 billion for fiscal year 1979, due to spreading of wage base effect over calendar year. The fiscal year totals as published in the July 1978 Survey of Current Business are based on unadjusted data and do not conform to the average of four seasonally adjusted quarters. The FRB staff estimates, therefore, have been adjusted in order to make the Commerce Department and the staff estimates comparable.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. The aggregate volume of funds flowing through financial markets in recent weeks appears to have remained about in line with that recorded earlier in the fall, but there has been some shifting in the pattern. Short- and intermediate-term borrowing by nonfinancial businesses strengthened further in November, as firms stepped up their issuance of commercial paper while continuing to tap bank lines at about the same pace as in October. Business demands for longer-term funds, on the other hand, have remained moderate with the volume of long-term bonds and equities issued in November about in line with October's reduced pace.

In the household sector, home mortgage borrowing appears to have picked up somewhat further in November, in lagged association with a sharp increase in S&L mortgage commitments in October. At the same time, household borrowing in consumer credit markets in November appears likely to have remained at about the reduced October pace, as an increased volume of repayments and smaller extensions of auto credit probably about offset a step-up in extensions of new loans in conjunction with the strengthening of sales of other durable goods. However, growth in consumer debt continues to outpace the expansion of GNP and disposable personal income.

Bond offerings by State and local governments increased sharply in November and early December, reflecting substantial debt issuance to finance the activities of New York City and a comparatively heavy volume of securities sold by various housing authorities. The U.S.

Treasury, on the other hand, has raised no new money in the market from private domestic investors since the completion of its mid-quarter refunding operation. The Treasury's reduced borrowing activity is attributable in part to substantial sales of securities, particularly nonmarketable issues, to foreign official institutions over the first half of the current quarter. Since mid-November, foreign central banks have acquired about \$550 million of additional securities directly from the Treasury. At the same time, however, they have sold about \$1.5 billion of Treasury issues in the market.

There has been a general further weakening of growth in the key monetary aggregates in recent weeks, in part reflecting the lagged impacts of the sharp rise in market interest rates since last summer. M-1 is estimated to have declined in November at about a 4-1/4 per cent annual rate, with transfers from demand to ATS accounts believed to account for about 3 percentage points of this reduction. Despite the growth of ATS accounts, savings deposits declined at about a 10 per cent annual rate in November, with the size of this record one-month drop somewhat of a puzzlement. Small time deposit growth has also moderated, even though sales of money market certificates apparently remained brisk. The weakness in these various components of M-2 was only partly offset by a surge in growth of large denomination time deposits, and thus M-2 increased at only a 6-1/4 per cent annual rate in November. Deposit growth also slowed somewhat at nonbank thrift institutions in November, despite record sales of the money market certificates.

Short-term market interest rates have increased on balance since the November FOMC meeting, responding to the rise of the Federal funds rate from around 9-5/8 per cent to the 9-7/8 per cent area. Yields on corporate bonds also have edged slightly higher, and those on long-term Treasury and municipal securities show somewhat larger advances. The average of rates on S&L commitments to make conventional mortgage loans has increased 15 basis points to 10.35 per cent.

Outlook. Aggregate credit flows over the winter are expected to be similar to those recorded so far in the current quarter. The small projected increase in business spending on plant and equipment and inventories will be associated with only a marginal rise in external financing needs. Reports from underwriters and banks suggest that firms will continue to meet a major share of financing requirements in shorter-term credit markets. As a result, the ratio of short-term to total liabilities will continue to rise. Despite this development, barring a major change in interest rate expectations, it appears that firms will remain reluctant to fund their indebtedness at current levels of bond yields.

Growth in mortgage credit is likely to be sustained at a relatively rapid rate, as the commitments recently built up at thrift institutions are taken down. If, as expected, deposit growth at thrift institutions continues to be damped by the recent rise in market interest rates, mortgage market conditions will tighten further. With prevailing discounts on FHA/VA mortgages already at 4-5 points, pressures may mount to raise the ceiling rates on these loans from the current 9.50 per cent. The

sponsored housing agencies are expected to continue issuing debt in heavy volume in order to bolster the availability of funds at S&L's and to provide funds directly in the mortgage market. Moreover, insurance companies and pension funds will likely channel an increased share of lendable funds into the mortgage market.

In the Government sector, borrowing by States and municipalities seems likely to match the average volume of recent months. The U.S. Treasury's deficit in the first quarter of next year is expected to be roughly equivalent to that of the fourth quarter. The Treasury's issuance of marketable debt to private investors will likely be substantially greater, however. This assumes, of course, that foreign central bank demands for Treasury issues arising from exchange rate intervention in support of the dollar will not be large.

Both short- and long-term market interest rates appear to have adjusted fully to the recent pattern of credit flows and to current money market conditions. Thus, with aggregate credit demands expected to remain about unchanged in coming months, market interest rates would appear likely to fluctuate around current levels, barring a further tightening of monetary policy.

INTERNATIONAL DEVELOPMENTS

The trade-weighted average value of the dollar has risen by somewhat less than 1 per cent over the four weeks since the last green book. It remains about 9 per cent above the low reached just prior to the November 1 dollar-support measures. The emergence of pressure on the dollar during the first two weeks of December was met by forceful U.S. exchange-market intervention.

The des' has made net sales of foreign currencies of about \$880 million equivalent for the System and nearly \$520 million equivalent on behalf of the Treasury. Swap drawings to finance the System's share of this intervention have raised outstanding System swap drawings to \$4.6 billion.

On December 5, the heads of state of EC countries announced an agreement to launch on January 1 the much-heralded European Monetary System. The United Kingdom decided not to join the System at the outset, and the Irish government is expected to announce its intentions soon. The Italian parliament is considering the Italian Cabinet's recommendation that Italy join the EMS with initial margins wider than the $\pm 2\frac{1}{4}$ per cent of the "snake". The main result of eight months of intensive negotiation and study is that France is joining the "snake" for the third time, and that a start is being made in developing some of the institutional elements necessary for the EC to evolve into an economic and monetary union. In a related development, Norway, not a member of the EC, has withdrawn from the present "snake" arrangement.

The U.S. October trade deficit of \$30 billion at an annual rate was somewhat smaller than the deficit rate recorded in the second and third quarters of this year. Exports and imports were near their month-earlier levels, substantially above levels recorded earlier this year. Exports of non-agricultural goods in recent months have shown considerable strength, with the average volume of these exports in September-October about 10 per cent above the average levels recorded in the previous six months.

Foreign official assets in the United States (excluding OPEC holdings) increased by \$6.3 billion in October,

. It is estimated that reserve holdings of G-10 countries and Switzerland increased by more than \$4 billion in November and the first week of December. OPEC assets in U.S. banks and securities increased by \$1.5 billion in October, attributable primarily to a shift by Venezuela of funds previously on deposit in the Euro-dollar market. Preliminary data for November indicate a \$3/4 billion decline in OPEC financial assets in the United States. For the year as a whole, we estimate a net decline of about \$2 billion of OPEC financial holdings in the United States. This decline is related to a tightening of liquidity positions of several OPEC members and some shift into non-dollar assets. The OPEC current-account surplus for the year is estimated at around \$5 billion, considerably below the rate expected earlier and a sharp decline from last year's surplus of about \$30 billion. The OPEC current-account surplus has declined sharply since mid-1977 as OPEC imports have continued to rise while petroleum revenues have fallen somewhat.

Banks and securities dealers reported a \$100 million net private capital outflow in October following a sizable inflow in September. For the first 10 months of the year, transactions by banks and securities dealers have resulted in a net capital outflow of about \$5 billion.

Economic activity abroad in recent months has picked up, especially in Germany, but there is some evidence of strength in Canada, France and Italy as well. Activity has slowed in the United Kingdom, and in Japan third-quarter real GNP results released recently make it virtually certain that Japan will not attain the 7 per cent growth rate target for the fiscal year that it pledged to achieve at the July Bonn Summit.

Outlook. The staff continues to expect economic growth rates abroad to be considerably stronger than that of the United States through 1979. Given this growth rate differential, as well as the continued effects of the past year's depreciation of the dollar and an upward revision in projected direct investment income receipts, the staff now foresees a sharper reduction of the U.S. current-account deficit for 1979 than a month ago. The staff projects that the current-account deficit will decline from \$17 billion this year to less than \$7 billion in 1979. By the final quarter of next year we project a current-account deficit at about a \$2 billion annual rate. The average value of the dollar may be subject to some downward pressure in the short-run in response to the release of U.S. and foreign trade and price data. However, in view of the anticipated improvement in the course of 1979 in the U.S. current account and in the relative U.S. inflation performance, the staff expects no significant change in the trade-weighted average value of the dollar from current levels a year from now.

CONFIDENTIAL (FR)
CLASS II FOMCOutlook for U.S. Net Exp. and Related Items
(billions of dollars, seasonally adjusted annual rates)

	1977	1978 ^P	1979 ^P	1978				1979 ^P			
				I	II	III ^P	IV ^P	I	II	III	IV
1. GNP NET EXPORTS - Intl Acct. data	-11.1	-10.3	3.0	-23.8	-5.3	-6.6	-5.5	0	-.1	4.5	7.6
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(-10.9)	(-10.4)	(3.0)	(-24.1)	(-5.5)	(-6.6*)	(-5.5)	(0)	(-.1)	(4.5)	(7.6)
3. a) Merchandise Trade Balance	-31.1	-35.1	-27.2	-44.8	-31.2	-31.8*	-32.6	-28.7	-29.9	-26.5	-23.9
4. Exports (excl. military)	120.6	141.5	170.7	122.7	140.3	148.1*	154.9	161.3	167.2	173.9	180.4
5. Agricultural	24.4	29.9	30.0	26.0	32.0	31.5*	29.9	30.2	29.7	30.0	29.9
6. Nonagricultural	96.2	111.6	140.7	96.6	108.3	116.6*	125.0	131.1	137.5	143.9	150.5
7. Imports	151.6	176.6	197.9	167.5	171.5	179.9*	187.5	190.0	197.1	200.4	204.3
8. Petroleum and petrol. products	45.0	42.8	47.9	39.8	43.2	43.3*	45.0	44.6	48.4	48.9	49.9
9. Nonpetroleum	106.7	133.8	150.0	127.7	128.2	136.6*	142.5	145.4	148.7	151.5	154.4
10. b) Military transactions, net <u>2/</u>	.9	1.6	3.0	.4	1.9	2.0	2.2	2.4	2.8	3.2	3.6
11. c) Investment income, net <u>3/</u>	17.3	20.5	23.6	18.4	21.3	20.4	21.8	22.9	23.4	24.0	24.0
12. d) Other services, net <u>4/</u>	1.7	2.7	3.7	2.2	2.8	2.8	3.1	3.4	3.6	3.8	3.9
13. U.S. CURRENT ACCOUNT BALANCE	-15.3	-17.1	-6.7	-27.4	-13.0	-14.0	-14.0	-9.6	-10.1	-5.2	-2.1
14. a) GNP net exports (line 1.)	-11.1	-10.3	3.0	-23.8	-5.3	-6.6	-5.5	0	-.1	4.5	7.6
15. b) U.S. Govt & private transfers <u>5/</u>	-4.2	-6.8	-9.7	-3.6	-7.7	-7.4	-8.5	-9.6	-10.0	-9.7	-9.7
Constant (1972) dollars											
16. Merchandise exports (excl. military)	67.0	72.4	80.9	65.7	72.9	74.2	76.8	78.5	79.8	81.7	83.6
17. (% change, annual rates)	(0.3)	(8.1)	(11.7)	(4.5)	(51.3)	(7.4)	(14.3)	(9.5)	(6.6)	(10.0)	(9.1)
18. Merchandise imports	71.0	76.2	79.8	74.4	74.0	77.1	79.3	78.4	79.8	80.2	80.9
19. (% change, annual rates)	(13.0)	(7.3)	(4.7)	(6.6)	(-2.0)	(17.9)	(11.7)	(-4.9)	(7.4)	(2.4)	(3.2)
Foreign Outlook - Ten Industrial Countries <u>6/</u>											
20. Real GNP, % change, annual rates	2.9	3.7	4.0	5.5	4.1	3.2	3.6	4.5	4.3	4.0	4.0
21. Consumer Prices, <u>7/</u> % change, A.R.	7.9	5.4	6.1	4.9	6.8	3.9	5.7	6.3	6.4	7.3	7.4

1/ Differs from 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, and reinvested earnings of incorporated affiliates 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, and reinvested earnings of incorporated affiliates.6/ Weighted by the shares of Canada, France, Germany, Italy, Japan, United Kingdom, Netherlands, Sweden, Belgium, and Switzerland in the sum of the real GNP of the ten countries in dollar terms.7/ Wholesale prices for Japan.^P/ Projected.^E/ Estimated.^{*}/ Published data.