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CONFIDENTIAL (FR)

January 30, 1980

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

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SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest Data			Percent Change from		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year earlier
					(At annual rate)	
Civilian labor force	Dec.	1-11-80	104.0	4.0	2.0	2.1
Unemployment rate (%) 1/	Dec.	1-11-80	5.9	5.8	5.8	5.9
Insured unemployment rate (%) 1/	Dec.	1-11-80	3.1	3.0	3.0	3.1
Nonfarm employment, payroll (mil.)	Dec.	1-11-80	90.4	4.2	2.8	2.6
Manufacturing	Dec.	1-11-80	21.0	6.2	.1	.3
Nonmanufacturing	Dec.	1-11-80	69.5	3.6	3.6	3.3
Private nonfarm:						
Average weekly hours (hr.) 1/	Dec.	1-11-80	35.7	35.7	35.7	35.8
Hourly earnings ($) 1/	Dec.	1-11-80	6.39	6.33	6.26	5.92
Manufacturing:						
Average weekly hours (hr.) 1/	Dec.	1-11-80	40.3	40.1	40.2	40.6
Unit labor cost (1967=100)	Dec.	1-30-80	181.8	10.7	11.5	8.3
Industrial production (1967=100)	Dec.	1-16-80	152.2	3.2	-.5	.3
Consumer goods	Dec.	1-16-80	149.1	1.6	-1.6	-1.6
Business equipment	Dec.	1-16-80	173.8	11.9	.5	4.2
Defense & space equipment	Dec.	1-16-80	96.2	8.8	9.4	5.3
Materials	Dec.	1-16-80	155.8	1.5	-1.3	-.3
Consumer prices all items (1967=100)	Dec.	1-25-80	230.3	14.8	12.9	13.3
All items, excluding food & energy	Dec.	1-25-80	218.1	11.1	12.5	11.3
Food	Dec.	1-25-80	243.4	16.0	10.6	10.0
Producer prices: (1967=100)						
Finished goods	Dec.	1-10-80	228.0	9.5	12.7	12.5
Intermediate materials, nonfood	Dec.	1-10-80	261.6	14.4	16.1	16.3
Crude foodstuffs & feedstuffs	Dec.	1-10-80	255.8	-1.4	9.4	11.1
Personal income ($ bil.) 2/	Dec.	1-17-80	2022.5	13.5	12.7	10.7
					(Not at annual rates)	
Mfrs. new orders dur. goods ($ bil.)	Dec.	1-24-80	75.9	.6	-2.2	-1.3
Capital goods industries	Dec.	1-24-80	26.6	4.4	2.0	14.4
Nondefense	Dec.	1-24-80	23.1	7.9	6.0	20.8
Defense	Dec.	1-24-80	3.4	-14.5	-18.8	-15.8
Inventories to sales ratio: 1/						
Manufacturing and trade, total	Nov.	1-24-80	1.42	1.41	1.42	1.40
Manufacturing	Nov.	1-24-80	1.57	1.54	1.54	1.49
Trade	Nov.	1-24-80	1.28	1.29	1.31	1.31
Ratio: Mfrs.' durable goods inventories to unfilled orders 1/	Nov.	1-24-80	.570	.566	.564	.573
Retail sales, total ($ bil.)	Dec.	1-11-80	77.0	1.1	.1	8.6
GAF 3/	Dec.	1-11-80	16.6	-.4	.3	7.5
Auto sales, total (mil. units.) 2/	Dec.	1-7-80	10.6	12.2	-1.1	-4.6
Domestic models	Dec.	1-7-80	7.8	14.0	-8.3	-14.7
Foreign models	Dec.	1-7-80	2.8	7.5	27.2	43.9
Plant & Equipment expen. ($ bil.) 4/						
All industries	1980	1-10-80	195.67	—	—	10.9
Manufacturing	1980	1-10-80	89.51	—	—	14.3
Nonmanufacturing	1980	1-10-80	106.16	—	—	8.2
Housing starts, private (thous.) 2/	Dec.	1-17-80	1,527	.3	-20.5	-26.4
Leading indicators (1967=100)	Dec.	1-30-80	136.8	.0	-2.2	-4.3

1/ Actual data used in lieu of percent changes for earlier periods.
2/ At annual rate.
3/ Excludes mail order houses.
4/ Planned-Commerce November 1980 Survey.

Economic activity apparently continued to expand at a moderate rate through the end of the year. Increases in employment and nominal personal income were sizable in December, and the unemployment rate remained in the range that has prevailed over the last year and a half. In addition, the growth in nominal retail sales strengthened and industrial production increased. At the same time, there were further indications of weakness in some key sectors: housing starts continued at a sharply reduced pace, consumer sentiment remained depressed, and substantial auto-related layoffs persisted through January. Finally, the rate of increase in both consumer and producer prices excluding food accelerated in December.

Employment and Production

Labor demand remained firm through the middle of December as nonfarm payroll employment rose 315,000 from a month earlier. In contrast to recent months, jobs increased in goods-producing as well as service-producing industries. Manufacturing employment rose 110,000, after four months of decline, but remained below its peak level of last July. Sizable gains were posted in the machinery and equipment industries, and the factory workweek rose 0.2 hour to 40.3 hours. Hiring in the service-producing sector remained strong with gains concentrated in the services, government, and finance sectors.

Total employment, as measured by the household survey, also rose about 300,000, but unemployment edged up slightly. The jobless rate--at 5.9 percent--remained within the 5.7 to 5.9 percent range (on the basis of revised seasonal factors) that has prevailed since mid-1978.

CHANGES IN EMPLOYMENT[1]
(Thousands of employees; based on seasonally adjusted data)

	1978	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Dec.
	--- Average monthly changes ---					
Nonfarm payroll employment[2]	334	302	196	59	208	317
Strike adjusted	318	304	205	62	220	303
Manufacturing	69	64	-3	-38	2	108
Durable	57	56	3	-8	-26	63
Nondurable	12	8	-6	-30	27	45
Construction	39	48	16	3	29	47
Trade, finance and services	169	150	113	77	133	97
Private nonfarm production workers	256	230	111	11	153	229
Manufacturing production workers	50	44	-19	-46	-4	106
Total employment[3]	275	264	10	284	136	304
Nonagricultural	268	282	35	244	138	330

1. Changes are from final month of preceding period to final month of period indicated.
2. Survey of establishments. Not strike adjusted, except where noted.
3. Survey of households.

SELECTED UNEMPLOYMENT RATES
(Percent; based on seasonally adjusted data)

	1973	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Dec.
Total, 16 years and older	4.9	5.8	5.8	5.8	5.9	5.9
Teenagers	14.5	15.9	16.1	16.2	16.1	16.0
20-24 years old	7.8	8.7	8.8	9.2	9.4	9.8
Men, 25 years and older	2.5	3.2	3.2	3.3	3.4	3.2
Women, 25 years and older	4.0	4.9	4.9	4.7	4.8	4.7
White	4.3	5.0	5.0	5.1	5.1	5.1
Black and other	8.9	11.4	11.5	10.9	11.2	11.3
Fulltime workers	4.3	5.2	5.2	5.3	5.4	5.4
White collar	2.9	3.4	3.3	3.4	3.3	3.3
Blue collar	5.3	6.5	6.8	7.1	7.3	7.2

Unemployment rates for major demographic groups were little changed from their November levels.

Since the December surveys were taken, there have been increases in insured unemployment, suggesting an emerging weakness in labor demand. In January, the level of insured unemployment, which has been trending up since the middle of last year, was on average somewhat above its December level. In addition, the number of workers on indefinite layoff in the automotive industry has increased to about 150,000, compared with 116,000 in mid-December; and there have been reports of layoffs in the tire and steel industries in recent weeks.

The layoffs in January came on the heels of continued cutbacks in production and capacity utilization in December in the motor vehicle and parts, iron and steel, and rubber industries. Utilization rates for most other manufacturing industries rose. On balance, manufacturers operated at 84.4 percent of capacity in December, the same as in November, but nearly 3 percent below the recent March peak.

Industrial production increased 0.3 percent in December following small declines in October and November. In December, production of equipment, consumer nondurable goods, and nondurable materials advanced. Output of business equipment rose 1.0 percent with gains throughout most of that sector, and production of defense and space equipment continued to advance. However, output of autos, trucks and parts fell once again in December, ending the year 26 percent below the level of a year earlier. Auto assemblies in December were at an annual rate of 6.8 million units, about 6 percent below the November pace, and January assemblies are expected to drop further to around a 5.9 million unit

INDUSTRIAL PRODUCTION
(Percentage change at annual rate[1]; based on seasonally adjusted data)

	1978		1979			
	H1	H2	H1	H2	Nov.	Dec.
Total	7.0	7.9	1.6	.3	-.3	.3
Final products	6.4	5.4	1.9	0.0	-.1	.5
Consumer goods	3.7	2.7	-.4	-2.4	-.5	.1
Durable	6.0	1.5	-6.7	-8.8	-2.0	-1.1
Nondurable	2.7	3.3	2.3	.5	.3	.6
Business equipment	10.2	8.6	6.1	2.4	.2	1.0
Materials	8.4	11.1	1.3	.4	-.5	.1
Durable	9.7	16.1	.5	-2.0	-1.2	-.1
Nondurable	9.9	6.3	3.7	5.0	0.0	.8
Energy materials	2.9	5.2	-1.2	1.1	.3	-.2

1. Rates of change for periods longer than one month are compound rates.

SELECTED CAPACITY UTILIZATION RATES FOR U.S. INDUSTRY
(Percent, seasonally adjusted)

	1973-1974 High	1979			Dec. 1979 less Mar. 1979[2]
		March[1]	Nov.	Dec.	
Manufacturing	88.0	87.1	84.4	84.4	-2.7
Primary processing	93.8	88.6	86.5	86.5	-2.1
Advanced processing	85.5	86.2	83.3	83.3	-2.9
Electrical machinery	88.7	90.5	91.2	91.7	1.2
Motor vehicles and parts	98.7	92.3	70.1	67.4	-24.9
Aerospace and miscellaneous transportation equipment	77.5	87.9	92.2	92.1	4.2
Materials	92.6	88.3	85.9	85.7	-2.6
Durable goods materials	91.5	87.5	83.6	83.2	-4.3
Basic iron and steel	104.8	89.4	81.8	81.7	-7.7
Nondurable goods materials	94.5	90.0	89.7	90.1	.1
Energy materials	94.6	87.6	86.5	86.2	-1.4

1. Recent peak.
2. Percentage points.

rate. Output of construction supplies also declined further in December, to a level almost 2 percent below the level a year earlier.

Personal Income and Consumer Spending

Personal income and consumer outlays continued to advance in December, although consumers reportedly remained pessimistic about prospects for economic activity generally and their personal financial conditions. Personal income rose at a 13-1/2 percent annual rate, a bit faster than the average pace earlier in the year. Private wage and salary disbursements also increased at a substantial rate for the second month in a row, reflecting both higher wage rates and employment gains. It appears that real disposable personal income advanced further in December, following moderate increases in October and November. After declining earlier in the year, real disposable income, at year end, stood about even with its December 1978 level.

Growth in consumer goods purchases moderated somewhat during the fourth quarter from the third quarter pace. In December, nominal retail sales increased about 1 percent after rising 3/4 percent in November; for the fourth quarter as a whole, retail sales rose 2.1 percent, half the third quarter gain. The slowing in retail sales from the third quarter has been concentrated in durable goods; nominal sales of furniture and appliances fell 2.7 percent in December and were down 7 percent from the August peak. In addition, spending at automotive stores, which has fluctuated from month to month, declined 2-1/2 percent during the fourth quarter. Sales of most major types of nondurable goods have been relatively well maintained.

PERSONAL INCOME
(Based on seasonally adjusted annual rate data)

	1978	1979	1979 Q4	1979 Nov.	1979 Dec.
	- - Percentage change, at annual rates[1] - -				
Total personal income	$12.9	11.0	11.6	12.6	13.5
Wage and salary disbursements	12.8	10.0	10.7	12.3	11.5
Private	14.0	10.8	10.9	13.8	13.5
Nominal disposable personal income	12.0	10.1	9.8	11.0	11.9
Real disposable personal income	4.2	.2	n.a.	3.6	n.a.
	- - Changes in billions of dollars[2] - -				
Total personal income	$17.8	$16.3	$20.8	$20.8	$22.5
Wage and salary disbursements	11.5	9.6	11.5	12.9	12.2
Private	10.1	8.4	9.6	11.7	11.6
Manufacturing	3.2	2.0	2.8	1.8	4.2
Other income	7.1	7.6	9.9	8.7	11.0
Transfer payments	1.5	3.0	2.2	1.0	3.5

1. Changes over periods of one quarter or more are from final quarter of preceding period to final quarter of period indicated. Changes for quarterly period are compounded rates of changes.
2. Average monthly change.

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

	1979						
	Q1	Q2	Q3	Q4	Oct.	Nov.	Dec.
Total sales	1.9	.5	4.2	2.1	-1.7	.7	1.1
(Real)[1]	-1.0	-2.1	2.2	-.3	-2.4	.0	.1
Total, less auto and nonconsumption items	1.7	2.4	4.1	3.4	.0	1.2	1.0
GAF[2]	-.4	2.4	5.3	1.5	-.3	1.0	-.4
Durable	1.6	-2.7	5.1	-1.3	-5.6	-.9	1.6
Auto	3.6	-7.1	3.9	-2.4	-8.8	.0	1.7
Furniture & appliances	1.7	2.3	8.1	-3.0	-1.2	-2.5	-2.7
Nondurable	2.1	2.3	3.7	3.9	.4	1.6	.9
Apparel	-1.1	.8	5.8	.0	-.7	-.5	5.6
Food	3.5	2.5	1.9	3.4	-.1	1.0	2.2
General merchandise[3]	-1.0	3.1	4.0	3.9	.3	2.9	-1.7
Gasoline	4.4	7.2	7.4	8.1	2.5	1.8	-.7

1. BCD series 59.
2. General merchandise, apparel, furniture and appliance stores.
3. General merchandise excludes mail-order nonstores; mail-order sales are also excluded in the GAF composite sales summary.

AUTO SALES
(Millions of units; seasonally adjusted annual rates)

	1979							
	Q1	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Total	11.6	10.7	10.8	9.8	10.7	9.3	9.4	10.6
Foreign-made	2.3	2.5	2.2	2.4	2.1	2.1	2.4	2.6
U.S.-made	9.3	8.2	8.6	7.4	8.7	7.2	7.0	8.0
Small	3.8	3.9	3.6	3.3	3.6	3.2	3.1	3.6
Intermediate & standard	5.4	4.1	4.9	4.0	4.9	4.0	3.8	4.2

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

Total new car sales in December were at a 10.6 million unit annual rate, somewhat above the low rates recorded in October and November. For the fourth quarter, sales were at a 9.8 million unit rate--the slowest pace since the end of 1975. Most of the December gain was in sales of U.S.-made autos, which increased from a 7 million unit annual rate to an 8 million unit rate. The surge in sales reflected in large part a continuation of company-sponsored incentive programs and increased availability of the more popular fuel-efficient models at the end of the year. Price discounting continued into the new year, and sales of U.S.-made models averaged a 7.9 million unit annual rate during the first twenty days of January. Sales of new foreign cars also increased in December, rebounding to about the record reached last spring, due primarily to greater supplies and to favorable pricing policies on some Japanese imports.

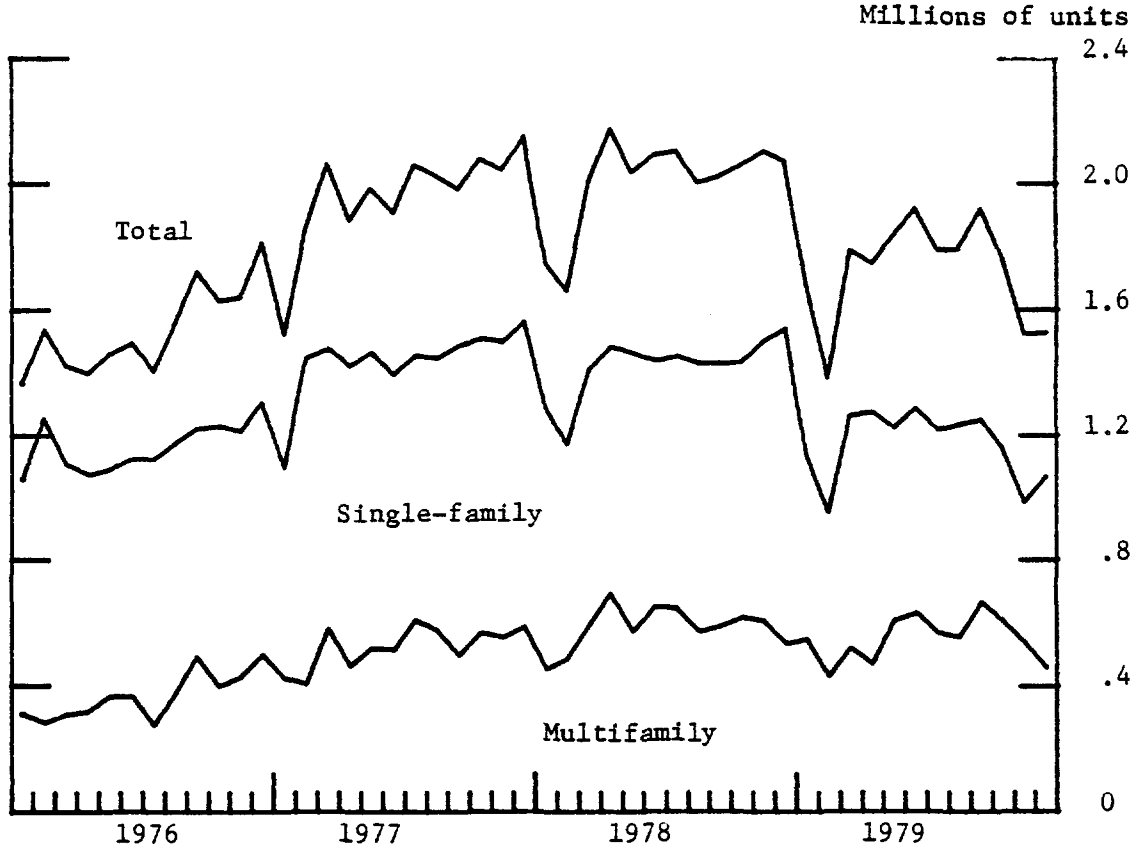
The University of Michigan Survey Research Center (SRC) index of consumer sentiment and the Conference Board index of confidence declined in December, both remaining at levels which in the past were associated with recessions. The latest surveys were notable for their extremely unfavorable opinions about the housing market. In addition, results from the SRC survey indicated for the second month in a row a higher proportion of survey respondents citing reduced credit availability and high interest rates as factors in their view that the present is not a good time to purchase large household durable goods; the buy-in-advance-of-inflation rationale that seemed to have bolstered purchases during the past two years now appears to be less important.

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

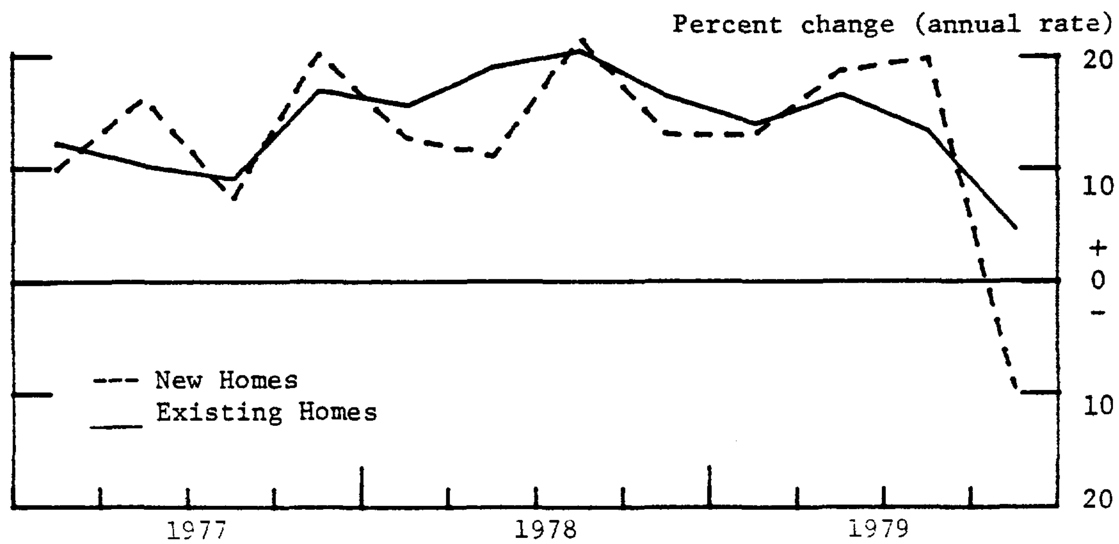
	1979						
	Annual	Q2	Q3	Q4	Oct.[1]	Nov.[1]	Dec.[2]
All units							
Permits	1.54	1.59	1.65	1.34	1.54	1.26	1.20
Starts	1.74	1.83	1.83	1.60	1.76	1.52	1.53
Single-family units							
Permits	0.97	1.03	1.02	.82	.93	.75	.77
Starts	1.19	1.26	1.24	1.07	1.16	.99	1.07
Sales							
New homes	n.a.	.71	.75	n.a.	.70	.60	n.a.
Existing homes	n.a.	3.73	3.88	n.a.	3.99	3.56	n.a.
Multifamily units							
Permits	.57	.56	.64	.52	.62	.51	.44
Starts	.55	.57	.60	.53	.61	.54	.46
Mobile home shipments	n.a.	.27	.28	n.a.	.29	.26	n.a.

1. Regular monthly revision.
2. Preliminary estimates.
n.a.--not available.

NEW PRIVATE HOUSING STARTS
(Seasonally adjusted annual rate)



RECENT CHANGES IN PRICES OF HOMES SOLD
(Based on seasonally adjusted prices)



NOTE: Quarterly data. 1979-Q4 is the average for October and November.

Residential Construction

Housing activity weakened noticeably toward the end of 1979. Total private housing starts were at a 1.5 million annual rate in December, virtually unchanged from November's reduced pace, but down significantly from the 1.8 million unit rate that had prevailed during the summer and early fall. In addition, newly issued building permits declined 5 percent in December and were more than 30 percent below their recent September peak.

Multifamily housing starts fell 15 percent in December to a 456,000 unit annual rate. These starts dropped throughout the fourth quarter, following the bulge in HUD-subsidized starts that was associated with the end of the fiscal year. Although single-family starts increased in December, for the fourth quarter as a whole these starts were 13 percent below the third quarter rate. In addition, total home sales declined sharply in November; and as a result, even though the stock of houses on the market was down, the ratio of unsold houses to monthly sales rose to 8.3, the highest level since March 1975. Moreover, preliminary data indicate another decline in home sales in December.

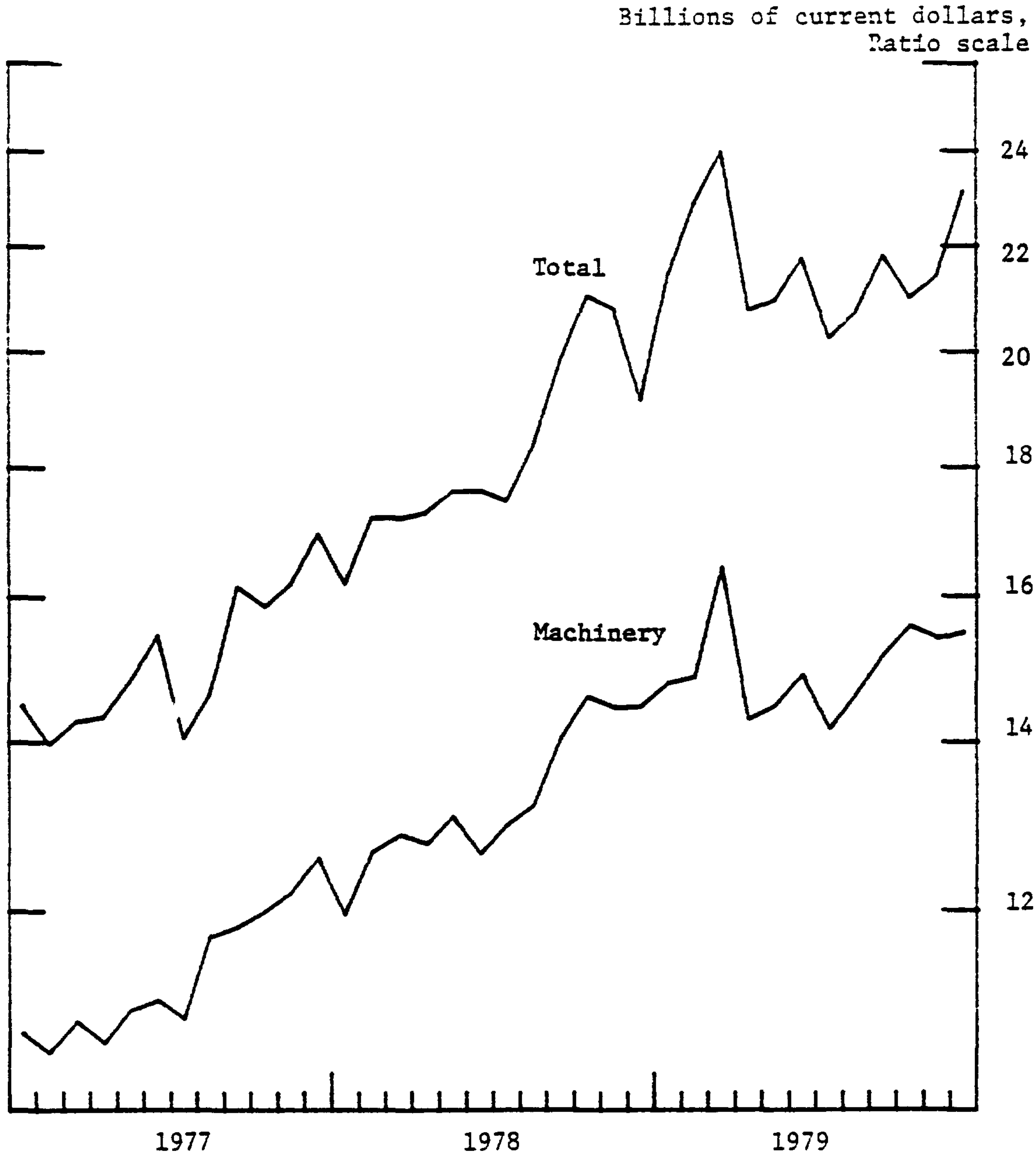
A distinct deceleration in home price movements provides further evidence of weakening housing demand. On a seasonally adjusted basis, increases in the price of existing homes sold slowed considerably during the first two months of the fourth quarter, while average prices of new homes actually fell during that period. Moreover, these trends in sales prices have been reported for most regions of the country.

COMPONENTS OF CURRENT DOLLAR
BUSINESS INVESTMENT SPENDING
(Percentage change from preceding comparable period,
based on seasonally adjusted data)

	1979						Dec. 1978 to Dec. 1979
	Q2	Q3	Q4	Oct.	Nov.	Dec.	
Nondefense capital goods shipments	-.6	5.4	0.8	0.4	-2.5	3.2	10.8
Nonresidential construction put-in-place	8.0	4.8	n.a.	4.5	-0.7	n.a.	17.1[1]
Building	10.9	5.1	n.a.	6.0	-0.8	n.a.	22.2[1]
Nonbuilding	4.3	4.4	n.a.	2.5	-0.5	n.a.	10.7[1]

1. Percentage change from November 1978 to November 1979.

NEW ORDERS NONDEFENSE CAPITAL GOODS
Seasonally adjusted



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

	1979[1]	Planned for 1980	
		McGraw-Hill	Commerce
All Business	14.7	9.5	10.9
Manufacturing	15.8	13	14.3
Durables	19.7	13	15.5
Nondurables	12.4	14	13.2
Nonmanufacturing	13.8	6	8.3
Mining	15.6	10	16.8
Transportation	26.6	3	10.4
Utilities	12.6	8	3.6
Communications, Commercial and other	12.1	5	10.0

1. November Commerce Survey, based on actual data for the first three quarters of the year and anticipations for the fourth quarter.

ERROR HISTORY OF THE COMMERCE DEPARTMENT ANNUAL SURVEY
(Percent change from prior year)

Year	Anticipated	Actual	Error[1]
1970	9.3	5.5	3.8
1971	1.4	1.9	-.5
1972	9.1	8.9	.2
1973	12.9	12.8	.1
1974	12.0	12.7	-.7
1975	4.6	.3	4.3
1976	5.5	6.8	-1.3
1977	11.3	12.7	-1.4
1978	10.1	13.3	-3.2
1979	11.2	14.7[2]	-3.5
1980	10.9	n.a.	n.a.

1. Anticipated minus actual percent change.
2. Based on November Commerce Survey.

Business Fixed Investment

Shipments of nondefense capital goods increased about 3 percent in December, primarily due to a sharp rebound by the construction equipment industry where a major strike was settled. Nondefense capital goods shipments had declined sharply in November, however, and for the fourth quarter as a whole they were up only 0.8 percent. Orders for nondefense capital goods increased sharply in December, rising 8 percent. This increase reflected a surge in new orders for aircraft and parts, a volatile series with long production lead times, while nondefense machinery orders, more indicative of short-run demand for capital equipment, rose only moderately.

Businesses continue to anticipate a slowing of capital spending growth in 1980 from the 1979 pace. The Commerce Department annual survey, taken in November and December, reported that firms plan to increase spending by 10.9 percent in 1980, compared with the 14.7 percent rise now indicated for 1979. Survey respondents expect capital goods prices to rise about 10 percent during 1980, and the planned increase in real plant and equipment outlays for 1980 is thus about 1 percent; this compares with the 6 percent rise during 1979. For the recession years 1970 and 1975, the Commerce Department December survey indicated increases in outlays that were about 4 percentage points larger than actually occurred.

Inventory Investment

Inventory investment slowed in November, the most recent month for which data are available. The book value of total manufacturing and trade inventories increased at an annual rate of $35 billion, down

BUSINESS INVENTORIES
(Billions of dollars; annual rate of change
in seasonally adjusted book values)

	1978	1979				
		Q1	Q2	Q3	Oct.	Nov.
Manufacturing and trade	41.5	49.1	56.3	45.5	46.5	35.4
Manufacturing	18.1	30.2	35.0	28.3	24.4	32.6
Durable	13.7	24.2	25.7	16.9	25.4	26.3
Nondurable	4.4	6.0	9.3	11.4	-1.0	6.3
Trade, total	23.5	18.9	21.3	17.2	22.1	2.8
Wholesale	12.8	13.2	4.7	12.6	4.7	-1.6
Retail	10.7	5.6	16.6	4.6	17.4	4.5

DEALER STOCKS OF AUTOMOBILES
(Millions of units; seasonally adjusted,
end of period)

	1978	1979					
		Q1	Q2	Q3	Q4	Nov.	Dec.
Total U.S.-made[1]	1.81	1.87	2.00	1.86	1.79	1.88	1.79
Standard	.46	.57	.70	.54	.55	.57	.55
Intermediate	.56	.58	.64	.54	.61	.64	.61
Compact	.54	.53	.52	.57	.36	.42	.36
Sub-compact	.25	.18	.14	.22	.27	.25	.27
Foreign-made	.70	.61	.43	.42	.49	.49	.49

1. Includes U.S.-made Volkswagons.

from the $50 billion average pace during the first ten months of the year. Accumulation of trade inventories moderated considerably in November from the fairly strong October pace, as a markedly slower rise in the book value of retail trade inventories was partly offset by a small decline in wholesale trade stocks. At manufacturers, the rate of book value accumulation picked up in November, with the inventory building concentrated in durable goods. The largest increase was in the stocks of the aircraft, missiles, and parts industry. Shipments by manufacturing and trade establishments were essentially unchanged in November, and the stock-sales ratio for all manufacturing and trade edged up to 1.42 from the October level of 1.41.

In December, dealer stocks of all U.S.-made automobiles appeared to have moved further into line with sales, following six months of imbalances. This adjustment reflected both the reduced level of auto assemblies and the sales incentive programs that have persisted throughout most of the second half. Stocks fell 90,000 units in December, three times the decline in the preceding month, and stood more than 300,000 units below the July peak. Excess inventories were still apparent for some large and intermediate models, however, while stocks of some small models remained in relatively short supply. The decline in total stocks evidently continued in January, since production was reduced below the apparent pace of sales.

Government Sector

The federal government deficit, measured on an NIPA basis, is now estimated to have been about unchanged in the fourth quarter from the third quarter's annual rate of $11.2 billion, as a sharp 4.0 percent

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

	1977[1]	1978[1]	1979[1]	1979	
				Q3	Q4
Output per hour					
Total private business	1.4	.8	-2.0	-1.3	-1.6
Nonfarm business	1.2	1.1	-2.3	-1.4	-.4
Manufacturing	2.6	1.6	.6	3.5	-1.5
Durable	1.9	.9	-.5	-.1	-1.6
Nondurable	3.6	2.6	2.3	9.0	-1.5
Compensation per hour					
Total private business	7.3	9.1	9.0	8.8	6.9
Nonfarm business	7.5	9.1	8.9	8.5	8.9
Manufacturing	8.0	8.7	9.1	8.1	8.2
Durable	8.3	8.4	8.8	8.0	7.5
Nondurable	7.1	8.7	9.6	8.1	9.8
Unit labor costs					
Total private business	5.8	8.3	11.3	10.3	8.7
Nonfarm business	6.2	7.9	11.5	10.1	9.3
Manufacturing	5.3	7.1	8.5	4.4	9.8
Durable	6.2	7.4	9.4	8.0	9.2
Nondurable	3.4	6.0	7.2	-.9	11.4

1. Percent change from fourth quarter of preceding year to fourth quarter of year indicated.

increase in receipts offset a similar increase in federal outlays. The 7 percent federal pay raise, sharply higher Commodity Credit Corporation (CCC) outlays, and increases in defense purchases all contributed to the strong growth of federal expenditures.

The administration now estimates that spending and receipts on a unified budget basis will total $564 billion and $524 billion, respectively, in fiscal year 1980. For fiscal year 1981, the administration has proposed a budget with outlays of $616 billion, receipts of $600 billion, and a deficit of $16 billion. The revised 1980 budget estimates and the 1981 budget incorporate the effects of the embargo on grain sales to the Soviet Union and the planned increase in defense spending. The grain embargo is expected to result in CCC direct purchases of $2.0 billion as well as $0.8 billion for the acreage set-aside program in fiscal year 1980. The increase in defense spending in fiscal year 1981 reflects the decision to raise the long-term rate of growth in defense budget authority from the previously planned 3 percent in real terms to 5 percent. (A detailed description of the President's budget will be presented in an Appendix in the Supplement to the Greenbook.)

State and local government employment increased about 40,000 in December, more than twice the average monthly rise earlier in the year. Employment was essentially unchanged in October and November, largely as a result of a sharp reduction in the public service employment program (part of CETA) beginning with fiscal year 1980. At the end of November, these jobs, which are aimed at hiring those unemployed for structural or cyclical reasons, were more than 30 percent below their 600,000 peak in August.

HOURLY EARNINGS INDEX[1]
(Percent change at compound annual rates;
based on seasonally adjusted data)[2]

	Dec. 77 to Dec. 78	Dec. 78 to Dec. 79	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Dec.
Total private nonfarm	8.5	8.2	8.5	7.1	8.5	8.1	9.9
Manufacturing	8.6	8.9	8.5	9.7	8.1	9.0	10.3
Durable	8.8	8.9	8.6	10.0	7.9	8.3	11.3
Nondurable	8.2	9.1	8.4	9.1	8.6	10.2	8.4
Contract construction	7.7	6.4	7.7	7.6	6.6	4.0	4.9
Transportation and public utilities	7.5	9.0	8.6	3.5	15.9	8.0	11.7
Total trade	9.6	7.3	10.3	5.8	7.2	6.6	5.3
Services	7.7	8.2	7.5	5.4	7.3	10.4	14.3

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime pay in manufacturing.
2. Changes for other than monthly and yearly periods are compounded.

MAJOR COLLECTIVE BARGAINING SETTLEMENTS
(Percent change at annual rates)

	Average adjustment 1975	1976	1977	1978	1979
Wage-rate settlements (1,000 or more workers)					
First year adjustments	10.2	8.4	7.8	7.6	7.4
Average over life of contracts[1]	7.8	6.4	5.8	6.4	6.0
Wage and benefit settlements (5,000 or more workers)					
First year adjustments	11.4	8.5	9.6	8.3	8.9
Average over life of contracts[1]	8.1	6.6	6.2	6.3	6.6
Effective wage-rate adjustments (1,000 or more workers)	8.7	8.1	8.0	8.2	8.8
Current settlements	2.8	3.2	3.0	2.0	2.8
Prior settlements	3.7	3.2	3.2	3.7	3.0
Escalator provisions	2.2	1.6	1.7	2.4	3.0

1. Excluding cost-of-living adjustments.

Productivity and Labor Costs

Labor cost pressures remained intense in late 1979, reflecting in part continued poor productivity performance. Output per hour in the private nonfarm business sector decreased at a 1/2 percent annual rate in the fourth quarter to a level 2-1/4 percent below a year earlier. This marked the fourth consecutive quarter of decline--the longest since the 1974-75 recession, when productivity fell for seven quarters.

Hourly compensation in the private nonfarm business sector rose at nearly a 9 percent annual rate in the fourth quarter; this increase, combined with the drop in productivity, drove unit labor costs to a level 11-1/2 percent higher than a year earlier. In December, wage rates for nonfarm production workers, as measured by the index of average hourly earnings, rose at a 10 percent annual rate to a level 8-1/4 percent above a year ago. Manufacturing wages also increased at a 10 percent annual rate, somewhat above the gains registered earlier in the quarter, and wages in the transportation and services sectors were also up sharply in December.

"Effective" wage rate increases for workers covered by major contracts, which include new settlements, deferred increases, and cost-of-living adjustment (COLA) payments, have been relatively moderate given the acceleration of prices; they were 8-3/4 percent in 1979, up from 8-1/4 percent during 1978. First-year wage-rate increases in major collective bargaining settlements (those covering 1,000 or more workers) averaged 7-1/2 percent in 1979, about the same as in the previous year. Over the life of the contracts, annual wage advances excluding potential increases under COLA clauses were set at 6 percent in 1979, down from

6-1/2 percent in 1978. For larger units, where data are reported on fringe benefits as well as wages, settlements provided increases of about 9 percent in the first year, and about 6-1/2 percent annually over the life of the contract (excluding COLAs).

Prices

Recent data indicate that inflation accelerated at the end of last year. In December, consumer prices increased 1.2 percent, a bit above the pace prevailing throughout most of the year. As a result, the consumer price index (CPI) increased 13.3 percent over the year, a marked speedup from the 9 percent rise during 1978. Producer prices of finished goods rose less in December than in recent months, reflecting a slight decline in prices of consumer foods, but were 12-1/2 percent above a year earlier; excluding food, the rate of increase in these prices accelerated in December.

Consumer prices of energy items resumed their rapid rate of rise in December. As a result of recent hikes in crude oil prices, gasoline and fuel oil prices rose 2-3/4 and 1-1/2 percent, respectively. Moreover, further large increases have been announced by major refineries and will likely show up in the CPI during the next few months. Additionally, transportation costs have been boosted by price increases for new U.S.-made autos that were effective early in January.

Food prices at the consumer level picked up in December as meat prices rose substantially following earlier increases in livestock prices. Food price behavior was quite volatile in 1979. Over the year these prices increased about 10 percent, moderately below the rise of nearly 12 percent during 1978.

RECENT CHANGES IN PRODUCER PRICES
(Percentage change at annual rates; based on seasonally adjusted data)[1]

	Relative importance Dec. 1978	Dec. 77 to Dec. 78	Dec. 78 to Dec. 79	1979		
				Oct.	Nov.	Dec.
Finished goods	100.0	9.2	12.5	12.5	15.6	9.5
Consumer foods	25.4	11.9	7.5	-1.1	31.6	-1.5
Consumer nonfood	45.2	8.4	17.8	19.4	12.0	15.7
Energy	7.2	8.0	62.7	56.1	29.6	28.5
Exc. energy	38.1	8.5	9.3	9.1	7.1	12.8
Capital equipment	29.4	8.0	8.7	14.3	6.5	10.2
Intermediate materials[3]	94.6	8.3	16.3	22.4	10.8	14.4
Exc. food and energy	83.5	8.9	12.8	20.1	7.9	11.3
Crude food materials	58.6	18.3	11.1	5.8	23.9	-1.4
Crude nonfood	41.4	15.6	26.6	33.7	24.1	31.9
Exc. energy 4/	11.2	21.3	18.1	52.5	47.3	-3.3

1. Changes are from final month of preceding period to final month of period indicated. Changes for other than monthly and yearly periods are compounded.
2. Relative importance weights are on a stage of processing basis.
3. Excludes intermediate materials for manufacturing food and animal feed.
4. Also excludes agricultural nonfood materials.

RECENT CHANGES IN CONSUMER PRICES[1]
(Percentage change at annual rates; based on seasonally adjusted data)[2]

	Relative importance Dec. 1978	Dec. 77 to Dec. 78	Dec. 78 to Dec. 79	1979		
				Oct.	Nov.	Dec.
All items	100.0	9.0	13.3	11.8	11.7	14.8
Food	18.2	11.8	10.2	9.1	6.5	16.0
Energy[3]	8.5	8.0	37.4	12.6	1.2	23.0
All items less food and energy[3]	73.3	8.5	11.3	11.9	14.0	11.1
Commodities	35.9	7.6	8.8	7.7	11.4	10.1
Services	37.4	9.3	13.7	15.0	13.3	15.6
Memoranda:						
Gasoline	4.2	8.5	52.2	21.0	20.6	32.4
Homeownership	23.6	12.4	19.8	23.0	25.6	20.8

1. Based on index for all urban consumers.
2. Changes are from final month of preceding period to final month of period indicated. Changes for other than monthly and yearly periods are compounded.
3. Not seasonally adjusted. Energy items: gasoline and motor oil, fuel oil and coal, gas and electricity.

In December, the CPI was boosted once again by a large rise in the homeownership cost component. Over the year, homeownership costs contributed more than 1-1/2 percentage points and energy items 2-1/2 percentage points to the 4.3 percentage point acceleration in consumer prices. There also was some acceleration in the rate of price increase outside these sectors, notably for new cars and rents.

In December, the BLS released five experimental estimates of the change in consumer prices (shown as 12-month percentage changes only) which are based on alternative approaches to measuring changes in homeownership costs. These reflect both different price series and weighting schemes and indicate increases in the total CPI during 1979 ranging from 10.8 to 13.2 percent, compared with the 13.3 percent rise in the published CPI.

The recent surge in spot prices of precious metals contributed to a significant rise in the December producer price index for intermediate materials. Between mid-December and mid-January spot market prices of gold and silver exploded--apparently associated with developments in the Middle East--suggesting the possibility of further upward pressure in intermediate materials prices. Large increases also have occurred in prices of other nonferrous metals, such as copper, and in prices of energy-related items such as chemicals and plastics.

Agricultural Developments

On January 4 the President announced that 1980 grain shipments to the Soviet Union would be limited to 8 million metric tons, 17 million tons less than the higher ceiling which had been approved earlier. The administration has estimated, however, that grain exports would be

FACTORS CONTRIBUTING TO THE CPI ACCELERATION, 1978 TO 1979

	Relative importance Dec. 1978	Price change[1] 1978	Price change[1] 1979	Acceleration (1979-1978)	Contribution to acceleration in CPI total
		- - Percent - -		- - Percentage points - -	
CPI, All items	100.0	9.0	13.3	4.3	4.3
Food	18.16	11.8	10.2	-1.6	-.3
Energy	8.50	8.0	37.4	29.4	2.5
Homeownership	23.56	12.4	19.8	7.4	1.7
Used cars	3.15	13.6	2.2	-11.4	-.4
Other[2]	46.63	6.2	7.6	1.4	.7

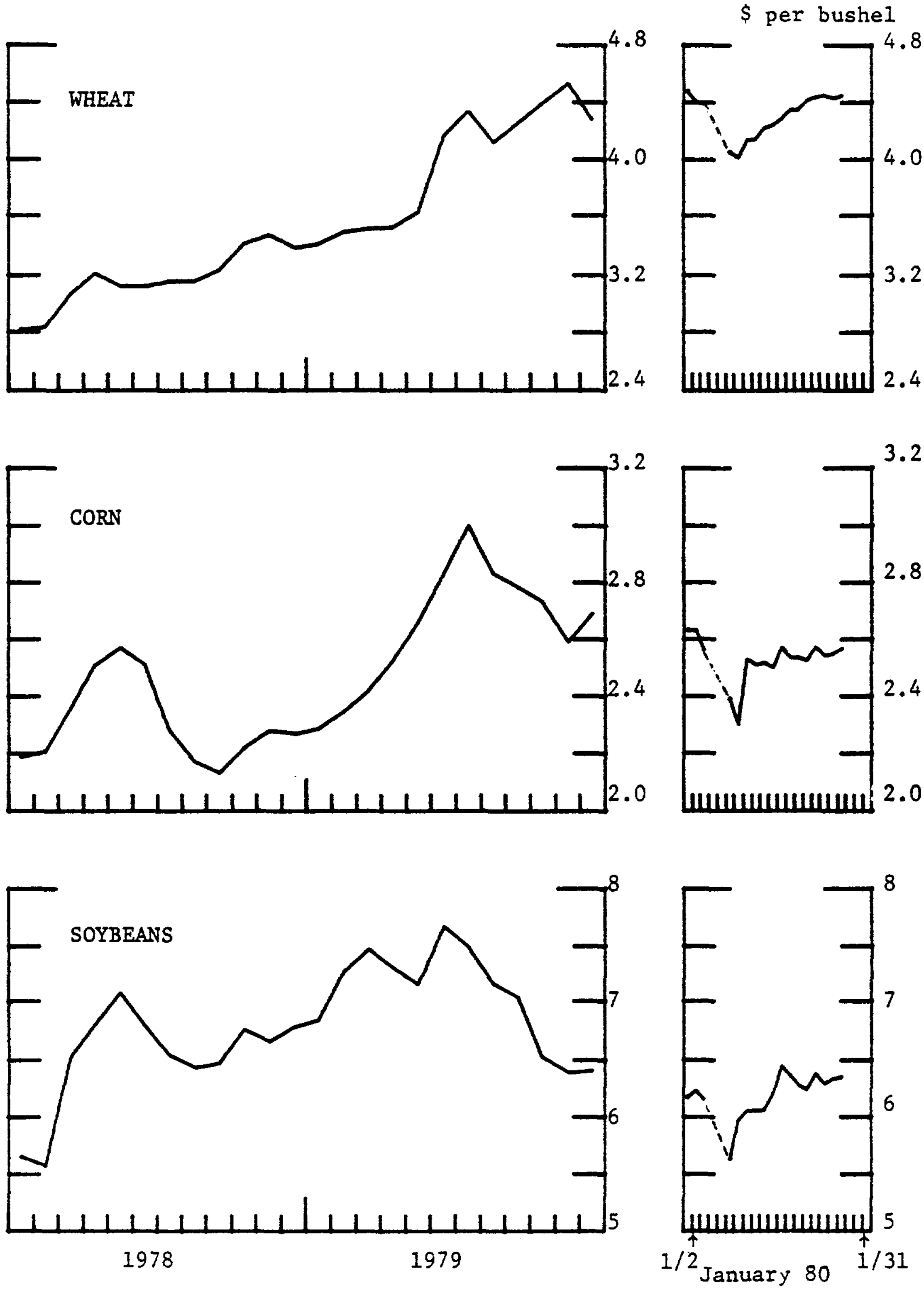
1. Percent change from December of previous year to December of year indicated.
2. Estimated.

reduced by this embargo by only 14 million tons since some reselling of grain to the Soviets by other countries is anticipated. In addition, soybean exports to the U.S.S.R. are to be reduced by 1 million metric tons.

To forestall possible sharp grain price reductions in response to anticipated increased supply, the administration took several steps to support these markets. On January 8, it announced an offer to purchase wheat, corn, and soybeans previously contracted for sale to the Soviet Union from grain exporters at original contract prices. In addition, further actions were taken to encourage greater stockpiling of grain by farmers through either the regular CCC loan program or through the farmer-reserve program.

Trading in agricultural commodities was suspended for two days following the announcement of the export embargo. Prices of grain then declined sharply in the first two trading sessions following the President's announcement. However, these prices began to recover as the administration's intention to support farm prices at about pre-embargo levels became more evident. As of late January, cash prices for grain at terminal markets were at about the levels immediately preceding the embargo. However, for corn the prospect of bulging domestic inventories over the next year has pushed futures prices somewhat below pre-embargo levels.

CASH PRICES FOR FARM CROPS



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SELECTED DOMESTIC FINANCIAL DATA

Indicator	Latest data		Net Change from:		
	Period	Level	Month ago	Three months ago	Year ago
	$ billions		Per cent at annual rates		
Monetary and credit aggregates[1]					
Total reserves	December	43.2	15.6	13.8	3.9
Nonborrowed reserves	December	41.7	29.3	13.0	2.6
Money supply					
M-1	December	382.1	5.4	3.1	5.7
M-2	December	952.6	5.4	6.8	8.4
M-3	December	1623.3	5.6	6.1	8.0
Time and savings deposits (less CDs)	December	570.5	5.5	9.4	10.2
CDs[2]	December	94.3	-0.7	6.2	-2.3
Thrift deposits (S&Ls + MSBs + Credit Unions)	December	670.7	5.8	5.0	7.4
Bank credit	December	1134.3	3.3	3.1	11.4

Indicator		Latest data		Net Change from:		
		Period	Per cent or index	Month ago	Three months ago	Year ago
Market yields and stock prices						
Federal funds	wk. endg.	1/23/80	13.77	.29	-1.37	3.73
Treasury bill (90 day)	"	1/23/80	12.08	-.12	-.52	2.70
Commercial paper (90-119 day)	"	1/23/80	13.02	-.67	.77	2.84
New utility issue Aaa	"	1/25/80	11.95	.67	.50	2.41
Municipal bonds (Bond Buyer)	1 day	1/24/80	7.33	.10	-.05	1.03
FNMA auction yield (FHA/VA)		1/23/80	13.11	.56	-.18	2.38
Dividend price ratio (common stocks)	wk endg.	1/23/80	5.28	-.27	-.48	.04
NYSE index (12/31/65=50)	end of day	1/28/80	65.96	4.22	8.91	9.11

		Net Change or Gross Offerings			
	Period	Latest Data	Year ago	Year to Date 1979	Year to Date 1978
Credit demands					
Business loans at commercial banks[1]	December	1.5	1.6	42.8	34.8
Consumer instalment credit outstanding[1]	November	2.4	3.8	34.2	38.8
Mortgage debt outstanding (major holders)[1/3]	October	9.5	9.6	85.5	93.0
Corporate bonds (public offerings)	December	1.4e	1.2	25.6e	19.8
Municipal long-term bonds (gross offerings)	January	3.3e	3.7	42.7e	48.5
Federally sponsored agcy. (net borrowing)	December	1.6e	2.9	23.9e	23.2
U.S. Treasury (net cash borrowing)	December	11.2	3.5	37.3	53.5

1/ Seasonally adjusted.
2/ $ billions, not at annual rates
3/ Includes comm'l banks, S&Ls, MSBs, life ins. cos, FNMA, and GNMA.
e - Estimated

In response to incoming data suggesting that economic activity may be less weak than anticipated over the near term and to recent decisions to step up defense spending, corporate and Treasury bond yields have advanced another 50 to 80 basis points since the January meeting and are currently at historic highs. Treasury bill rates, too, show net gains (generally about 30 to 50 basis points) for the intermeeting period, while private short-term rates are unchanged to up about 30 basis points. Short-term interest rates remain about 1/2 to 1-1/2 percentage points below their late October peak levels. In contrast to recent developments in other sectors of the credit markets, municipal bond yields and primary mortgage rates have remained essentially unchanged since early January.

The daily volatility of interest rates in the money market has subsided since October, although such fluctuations still tend to be somewhat larger than they were before October 6. Investor preferences for highly liquid, low risk securities have remained strong. Spreads between Aaa-rated corporate bonds and long-term Treasury securities, for example, are now around 120 basis points, compared with third- and fourth-quarter averages of 60 and 100 basis points, respectively.

Extending the uptrend that began in late October, equity prices have risen appreciably further in January, and many of the broad measures of stock prices are currently at all-time highs. The recent advances have been led by higher share prices of energy-related firms and defense contractors.

SELECTED FINANCIAL MARKETS QUOTATIONS
(percent)

	1974 High[1]	1979-1980[2] FOMC Oct.5	FOMC Jan.9	Jan.29	Change from: FOMC Oct.	FOMC Jan.
Short-term rates						
Federal funds[3]	13.55	11.91	13.94	13.77	2.09	-.17
Treasury bills						
3-month	9.63	10.70	11.76	12.26	1.59	.50
6-month	9.75	10.63	11.75	12.04	1.36	.29
1-year	9.54	10.28	10.76	11.28	.91	.52
Commercial paper						
1-month	12.25	11.73	13.07	13.03	1.31	-.04
3-month	12.25	11.86	13.04	13.06	1.23	.02
6-month	12.00	11.84	12.50	12.73	1.00	.23
Large negotiable CDs[4]						
1-month	12.58	12.09	13.33	13.17	1.25	-.16
3-month	12.64	12.50	13.36	13.37	.98	.01
6-month	12.30	12.80	13.33	13.60	.95	.27
Eurodollar deposit[3]						
1-month	13.78	12.45	14.59	14.05	2.55	-.54
3-month	14.01	12.79	14.56	14.20	1.65	-.36
Bank prime rate	12.00	13.50	15.25	15.25	1.75	.00
Intermediate- and long-term rates						
U.S. Treasury (constant maturity)						
3-year	8.84	10.01	10.68	11.26	1.09	.58
10-year	8.14	9.60	10.58	11.21	1.50	.63
30-year	n.a.	9.36	10.29	11.12	1.64	.83
Municipal (Bond Buyer)[5]	7.15	6.64	7.32	7.33	.69	.01
Corporate Aaa						
New issue[6]	10.61	10.22	--	11.95	1.73	--
Recently offered[7]	10.52	10.25	11.42	11.93	1.68	.51
Primary conventional mortgages[7]	10.03	11.35	12.85	12.89	1.52	.04

	1974 Low[8]	FOMC Oct.5	FOMC Jan.9	Jan.29	FOMC Oct.	FOMC Jan.
Stock prices						
Dow-Jones Industrial	577.60	897.61	850.09	874.40	-2.40	2.86
NYSE Composite	32.89	63.39	62.72	65.49	2.97	4.42
AMEX Composite	58.26	235.15	251.75	270.65	13.35	7.51
NASDAQ (OTC)	54.87	152.29	151.60	160.29	4.87	5.73

1. Statement week averages except where noted.
2. One-day quotes except as noted.
3. Averages for statement week closest to date shown.
4. Secondary market.
5. One-day quotes for preceding Thursday.
6. Averages for preceding week.
7. One-day quotes for preceding Friday.
8. Calendar week averages.

More complete data for the fourth quarter confirm a widespread weakening in credit flows in the private sector. Short- and intermediate-term business borrowing was down sharply from earlier in the year, and a reduction in long-term corporate security offerings more than offset a slight rise in commercial mortgage formation. The pace of home mortgage growth also dropped significantly in the fourth quarter, and consumer installment credit grew more slowly. In contrast, borrowing by governmental units at all levels increased sharply in the fourth quarter and has remained strong in January.

M-1 growth appears to have slowed to a 3-3/4 percent annual rate in January, from a 5-1/2 percent annual rate in December, as growth apparently continued to be depressed by the net rise of interest rates since last summer as well as by the recent slowing of economic activity. Time and savings deposit inflows to banks look stronger in January, and thus M-2 may expand somewhat more rapidly this month than last. Deposit growth at thrift institutions appears to have slowed somewhat further in January.

Monetary Aggregates and Bank Credit

The apparent slowing of M-1 growth in January is attributable to a marked drop-off in the pace of demand deposit expansion. Currency growth, on the other hand, rebounded sharply—after three months of relatively weak expansion—to account for over one-half of the growth of M-1.

Expansion of the interest-bearing component of M-2 accelerated a bit in January, reflecting moderation in both net withdrawals from savings deposits and runoffs of large time deposits included in M-2. At the same time, growth of small time deposits has been sustained, apparently

MONETARY AGGREGATES
(Based on seasonally adjusted data)[1]

	1979 Q1	1979 Q2	1979 Q3	1979 Q4[p]	1979 Dec.[p]	1980 Jan.[e]	Jan. '79 to Jan. '80[e]
	Percentage Change at Annual Rates						
Major monetary aggregates							
1. M-1	-1.3	8.1	9.7	5.0	5.4	3.8	6.4
2. Currency	9.1	7.3	11.1	8.5	5.7	11.3	9.0
3. Demand deposits	-5.3	8.3	9.3	3.7	5.2	0.9	5.4
4. M-2	2.8	8.8	11.9	8.9	5.4	6.4	9.0
5. M-3	5.3	8.0	10.5	7.8	5.6	5.7	8.2
Bank time and savings deposits							
6. Total	9.5	1.1	8.9	14.6	3.6	8.7	8.1
7. Other than large negotiable CDs at weekly reporting banks	5.8	9.3	13.3	11.5	5.5	8.2	10.7
8. Savings deposits	-11.8	-3.5	5.8	-13.8	-9.8	-6.9	-5.8
9. Individuals[2]	-10.4	-4.0	6.8	-12.6	-9.8	-6.2	-5.3
10. Other[3]	-30.6	0.0	-5.5	-33.6	-18.5	-9.4	-12.4
11. Time deposits	19.3	18.4	18.5	28.1	14.7	16.8	22.7
12. Small time[4]	20.3	35.9	25.7	30.0	27.8	26.2	33.5
13. Large time[4]	17.6	-11.8	4.1	24.5	-12.3	-3.1	4.4
14. Time and savings deposits subject to rate ceilings (8+12)	2.7	15.0	15.7	8.3	10.4	11.1	12.4
Deposits at nonbank thrift institutions[5]							
15. Total	8.8	6.8	8.4	6.2	5.8	4.7	7.1
16. Savings and loan associations	11.3	7.8	9.2	8.8	8.2	6.9	8.9
17. Mutual savings banks	4.6	3.1	2.2	0.0	-1.7	0.8	1.7
18. Credit unions	0.8	8.3	19.3	-0.7	4.3	-4.2	6.4
	Average Monthly Change in Billions of Dollars						
MEMORANDA:							
19. Total U.S. govt. deposits[6]	-2.0	1.5	0.7	-0.8	2.4	1.6	0.0
20. Total large time deposits[7]	1.4	-6.3	2.6	3.6	-1.9	0.6	0.0
21. Nondeposit funds	5.3	4.8	5.2	-4.3	-7.3	n.a.	n.a.
22. Other[8]	2.0	1.3	2.2	-2.2	-1.0	n.a.	n.a.
23. Net due to related foreign institutions	3.3	3.6	2.9	-2.0	-6.3	n.a.	n.a.

1. Quarterly growth rates are computed on a quarterly average basis.
2. Savings deposits held by individuals and nonprofit organizations.
3. Savings deposits of business, government, and others, not seasonally adjusted.
4. Small time deposits are in denominations of less than $100,000. Large time deposits are in denominations of $100,000 and above excluding negotiable CDs at weekly reporting banks.
5. Growth rates are computed from monthly levels that are an average of current and preceding end-of-month data.
6. Includes Treasury demand deposits at commercial banks and Federal Reserve Banks and Treasury note balances.
7. All large time certificates, negotiable and nonnegotiable, at all CBs.
8. Consists of nondeposit borrowings of commercial banks from nonbank sources, calculated as the sum of federal funds purchased, security RPs, other liabilities for borrowed money (including borrowings from the Federal Reserve), and loans sold less interbank borrowings.
e--estimated. n.a.--not available. p--preliminary.

the result of good consumer response to the new 2-1/2-year certificate--as suggested by press reports--and a resumption of substantial sales of 6-month MMCs. Deposit growth at thrift institutions appears to have weakened slightly in January from the rates of recent months. Growth is likely to have been mainly in the form of time deposits with floating rate ceilings, as sample data for early January suggest a rebound in MMC flows and sizable S&L sales of the new 2-1/2-year certificate.

Investment by savers in nondeposit market instruments appears to have increased in January. In just the first three weeks of the month, the growth of money market mutual fund assets surpassed the record increase for a full month. Noncompetitive tenders in the Treasury's weekly bill auctions were also up strongly during this period.

After declining slightly in November, bank credit growth resumed in December--albeit at a slow pace--and reports from large banks for early January indicate a further pickup may be in process. A reduction in holdings of Treasury obligations in December was more than offset by acquisitions of other securities, mainly municipal bonds, and total investments grew at a modest rate. Total loans also increased slowly over the month, reflecting a modest rebound of business lending--following a slight November decline--and continued strong growth of real estate loans. The January pickup of bank credit growth appears attributable mainly to an acceleration of loan growth, particularly business loans.

With credit demands weak and core deposit growth somewhat stronger, commercial banks reduced their managed liabilities by about $9 billion in December. The bulk of the decline was in net borrowing from banks' foreign affiliates; about one-quarter of this reduction appeared attrib-

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT
(Percentage changes at annual rates, based on seasonally adjusted data)[1]

	1979 Q1p	Q2p	Q3p	Q4p	Nov.p	Dec.e	12 months ending Dec.e
	Commercial Bank Credit						
1. Total loans and investments at banks[2]	13.3	11.9	15.8	3.1	-0.5	3.3	11.4
2. Investments	7.6	5.4	8.5	3.5	3.0	2.1	6.4
3. Treasury securities	2.1	3.8	1.7	-6.3	-12.6	-7.6	0.3
4. Other securities	10.5	6.2	12.1	8.5	10.8	6.9	9.7
5. Total loans[2]	15.2	14.2	18.2	2.9	-1.7	3.7	13.2
6. Business loans	20.5	16.6	22.7	5.0	-1.6	6.2	17.2
7. Security loans	33.0	38.1	8.7	-90.2	-128.2	-13.0	-6.2
8. Real estate loans	14.6	13.0	14.7	14.2	13.2	13.5	14.9
9. Consumer loans	16.3	12.4	7.5	n.a.	6.0	n.a.	n.a.
	Short- and Intermediate-Term Business Credit						
10. Total short- and intermediate-term business credit (sum of lines 13,14 and 15)	20.8	20.1	27.4	n.a.	0.6	n.a.	n.a.
11. Business loans net of bankers acceptances	20.4	16.6	21.7	6.0	-0.4	4.7	17.2
12. Commercial paper issued by nonfinancial firms[3]	33.5	65.7	69.7	15.5	-33.6	69.1	53.4
13. Sum of lines 11 & 12	21.4	20.3	25.7	6.9	-3.5	10.4	19.9
14. Finance company loans to business[4]	16.6	17.7	9.4	n.a.	15.5	n.a.	n.a.
15. Total bankers acceptances outstanding[4]	24.8	23.3	74.9	n.a.	5.5	n.a.	n.a.

1. Average of Wednesdays for domestic chartered banks and average of current and preceding ends of months for foreign-related institutions.
2. Loans include outstanding amounts of loans reported as sold outright to a bank's own foreign branches, unconsolidated nonbank affiliates of the bank, the bank's holding company (if not a bank), and unconsolidated nonbank subsidiaries of the holding company.
3. Average of Wednesdays.
4. Based on average of current and preceding ends of months.
e--estimated. p--preliminary. n.a.--not available.

utable to a decline in weekend Eurodollar activity undertaken to generate cash items and thus reduce reserve requirements against net demand deposits. Banks also cut back on other nondeposit borrowing by about $1 billion on balance. On average during December, managed liabilities subject to marginal reserve requirements dropped to about $3-1/4 billion-from $5 billion in November--with member banks accounting for nearly all of this total.

Business Sector Finance

The resumption in December of business loan expansion at banks (net of bankers' acceptances held) is attributable entirely to large banks, with loans by these banks to Shell Oil Company accounting for about three-quarters of their total business loan expansion. Business loan growth slowed at foreign-related institutions in December and turned slightly negative at small banks.

The further sluggishness of bank business lending in December appeared attributable mainly to continued weakness of business demands for short- and intermediate-term credit associated with a reduced rate of inventory accumulation. In addition, businesses shifted a larger share of their borrowing into the commercial paper market, perhaps to take advantage of the widening of the spread between paper rates and bank prime rates.

Comparison of the August and November Surveys of Terms of Bank Lending suggests that rates banks charged on small loans rose less over this period than those charged on large loans. Thus, it appears small businesses have not experienced the inordinate increase in cost of funds at banks which some observers thought might occur.

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

	1979				1980		
	H1	QIII	QIV[p]	Dec.[p]	Jan.[p]	Feb.[f]	Mar.[f]
	Seasonally adjusted						
Corporate securities--total	4,335	4,825	3,600	3,175	3,900	3,450	3,600
Publicly offered bonds	2,125	2,425	1,875	1,650	2,200	1,900	2,000
Privately placed bonds	1,555	925	1,025	1,000	900	900	900
Stocks	655	1,475	700	525	800	650	700
	Not seasonally adjusted						
Publicly offered bonds--total	2,280	2,125	1,850	1,450	2,400	1,800	2,600
By quality[1]							
Aaa and Aa	1,225	1,275	950	650	1,600	--	--
Less than Aa[2]	1,055	850	900	800	800	--	--
By type of borrower							
Utility	700	575	1,080	1,325	1,315	--	--
Industrial[3]	635	875	575	125	535	--	--
Financial	945	675	195	0	550	--	--
Foreign securities--total[4]	408	517	435	375	550	300	300

p--preliminary. f--forecast.
1. Bonds categorized according to Moody's bond ratings.
2. Includes issues not rated by Moody's.
3. Includes equipment trust certificates.
4. Includes both publicly offered and privately placed bonds.

Gross public offerings of corporate bonds increased to $2.2 billion in January, seasonally adjusted, substantially above the reduced levels for the previous two months. The heavier volume reflected continued large offerings by public utilities and a resurgence of issues sold by financial concerns (mainly finance companies). Public offerings of bonds by industrial corporations also increased, but remained below last year's monthly average. Larger industrial corporations apparently are still reluctant to issue call-protected bonds at current unprecedented levels of interest rates, even though aggregate balance sheet ratios point to a marked erosion of liquidity.

Stock prices have climbed, on average, about 2 percent since the January FOMC meeting, and trading volume has been extraordinarily heavy. Most broadly based indexes of NYSE-listed issues are currently 2 to 3 percent above pre-October 6 levels, and the AMEX and NASDAQ indexes are at their record highs. The major stock price indicators have posted cumulative gains of 7 to 33 percent since late October, reflecting in part sizable increases in share prices of firms dealing in metals, petroleum, and natural gas products and, more recently, of aerospace and military hardware companies.

Government Debt Markets

The Treasury has issued an additional $4.4 billion of marketable debt and $1.3 billion of nonmarketable debt in January. Slightly over half of the marketable total was obtained by adding to regular weekly and monthly bill auctions, a continuance of the increased fourth-quarter emphasis on bill financing. The remainder was raised through a $1.5 billion sale of a 15-year bond and by adding to a 2-year note refunding.

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

	1979				1980		
	H1	QIII	QIV[e]	Dec.[e]	Jan.[e]	Feb.[f]	Mar.[f]
	Seasonally adjusted						
State and local government securities, gross offerings							
Total	5.07	5.49	5.55	5.60	5.00	4.55	5.20
Long-term	3.35	3.58	4.15	4.00	3.00	2.60	3.60
Short-term	1.72	1.91	1.40	1.60	2.00	1.95	1.60
U.S. government securities, net offerings							
U.S. Treasury[1]	3.28	1.69	3.94	3.57	5.34	9.13	4.77
Sponsored agencies	2.22	0.73	2.83	2.63	1.68	2.81	2.43
	Not seasonally adjusted						
State and local government securities, gross offerings							
Total	5.42	5.26	5.07	4.60	4.50	4.50	5.50
Long-term	3.54	3.38	3.89	3.30	3.00	2.80	3.80
Short-term	1.88	1.89	1.18	1.30	1.50	1.70	1.70
U.S. government securities, net offerings							
U.S. Treasury[1]	1.97	2.17	6.03	5.76	4.43	12.60	6.00
Sponsored agencies	2.09	1.31	2.53	1.65	1.29	1.82	2.25

e--estimate. f--forecast.
1. Marketable issues only.

Two DM-denominated note issues (maturities of 2-1/2 and 3-1/2 years) were sold in the German money market in late January to raise $1.1 billion equivalent, and this accounted for most of the nonmarketable issues sold by the Treasury over the month.

Federally sponsored credit agencies are expected to borrow about $1.7 billion in January, down substantially from the monthly average of the fourth quarter. The Federal Farm Credit Banks are continuing to raise money at last year's record pace, but borrowing by FHLB and FNMA has slowed considerably. The FHLBs are expected to raise little, if any, money this month. FNMA is expected to borrow only about $500 million (seasonally adjusted), about $200 million less than its expected net mortgage acquisitions; the difference will apparently be financed by reductions in other assets. The substantial volume of mortgages purchased by FNMA continues a trend that began in the fourth quarter and reflects the rising differential between interest rates on FNMA's outstanding commitments and current levels of mortgage rates.

Bond offerings by state and local governments dropped to $3 billion in January (seasonally adjusted), about $1.2 billion below the fourth-quarter monthly average. A sharp drop-off in hospital financing bonds due to new restrictions on federal guarantees of such issues partly explains this cutback. Single-family housing revenue bonds accounted for about 30 percent of the total municipal bonds offered in January, up from an average level of 13 percent in the fourth quarter.

Demand for tax-exempt securities has continued to be firm, and offerings coming to market in January have been well received. Casualty insurance companies and banks reportedly are acquiring municipal securi-

NET CHANGE IN MORTGAGE DEBT OUTSTANDING
(Seasonally adjusted annual rates, in billions of dollars)

	1978	1979			
	Q4	Q1	Q2	Q3	Q4[e]
By type of debt:					
Total	160	158	164	162	158
Residential	124	119	118	116	110
Homes	114	110	111	104	97
Multifamily	10	9	7	12	13
Nonresidential	36	39	46	46	49
Commercial	25	23	28	29	32
Farm	11	16	18	17	17
By type of holder:					
Commercial banks	35	33	34	34	33
Savings and loans	52	45	51	43	33
Mutual savings banks	6	6	4	4	2
Life insurance companies	13	11	11	13	17
FNMA and GNMA	9	12	8	2	10
GNMA pools	14	13	14	25	25
FHLMC and FHLMC pools	8	4	4	5	5
Other	23	34	38	36	34

1. Includes mortgage pools backing securities guaranteed by the Farmers Home Administration and sold to the Federal Financing Bank.
e--partially estimated.

ties in volume; municipal bond funds also have been growing rapidly in recent months. With offerings of tax-exempt issues down somewhat and demand for such issues remaining strong, yields on municipal bonds have remained unchanged in January in the face of the advances in corporate and Treasury bond yields.

Mortgage Markets

The sharp tightening of conditions in home mortgage markets that began in October continued through the end of the quarter. New mortgage commitments made by S&Ls fell another 15 percent in December, following a drop of 40 percent the previous month. Despite a sharp cutback in mortgage acquisitions, the level of outstanding commitments at S&Ls declined by 5 percent in December to $28 billion, the lowest level since mid-1977. For the fourth quarter as a whole, net residential mortgage lending by nonbank thrift institutions dropped by about one-fourth.

There are some signs that, within the primary market, the extreme tautness of the home mortgage market that characterized the fourth quarter may be easing, at least slightly, in January. A special FHLBB survey of commitment policies at large S&Ls indicated that about 40 percent of the 130 institutions contacted had liberalized their commitment policies in some way during the first half of January. By mid-January, 12 of the large S&Ls were still not making any new commitments, but this compares with 30 associations that had closed their commitment windows in October after the System's actions. About three-fourths of the S&Ls reported that the volume of new commitments in mid-January was substantially smaller than a year earlier, a slightly lower proportion than during the latter half of December.

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

Period	Conventional home mortgages: Average rate on new commitments for 80% loans (percent)	Conventional home mortgages: Basis point change from month or week earlier	Conventional home mortgages: Spread[1] (basis points)	Percent of S&Ls with mortgage funds in short supply[2]
1979--High	12.90	--	+174	88
Low	10.38	--	+64	54
1979--Aug.	11.09	0	+160	77
Sept.	11.30	+21	+143	83
Oct.	11.64	+34	+79	83
Nov.	12.83	+119	+147	86
Dec.	12.90	+7	+158	85
1980--Jan. 4	12.85	-5	+141	87
11	12.90	+5	+136	85
18	12.87	-3	+118	84
25	12.89	+2	+96	85

1. Average mortgage rate minus average yield on recently offered Aaa utility bonds.
2. Percent reporting supply of funds slightly or substantially below normal seasonal patterns.

Some large S&Ls (and banks) in California reportedly cut their prime mortgage rates by 1/4 percentage point around mid-January. In other sections of the country, however, such rates have been raised, and thus the average rate paid in the Nation remains just below the record high 12.90 percent level which prevailed throughout December.[1] In the secondary market for home mortgages, yields on GNMA-guaranteed securities have stayed about in line with the rising yields on intermediate-term Treasury issues. Average yields in the January 21 FNMA auctions of forward purchase commitments increased markedly as the volume of bidding picked up. The auction price for government-underwritten home loans bearing the current 11-1/2 percent ceiling rate fell to 90.6, implying deep discounts on loans originated in the primary markets.

Consumer Credit

Consumer installment credit growth slowed to an annual rate of 7-1/2 percent in December, according to preliminary data, lowering the annual rate of advance during the fourth quarter to about an 8-1/2 percent annual rate. Growth in automobile credit in particular slowed markedly over the quarter but the pace of advance in other types of consumer credit also moderated.

Increasing problems with repayment of consumer loans became evident during the third quarter, the latest period for which delinquency data are available. The delinquency ratio for closed-end consumer installment

1. In January, the average rate on new commitments rose 50 basis points in the Southwest. This largely reflected a sharp rise in lending rates in Texas which followed federal preemption of state usury laws enacted near year-end. The FHLMC has attempted to produce a consistent rate series unconstrained by usury limits, but rates in Texas had been carried in the series at their 12 percent usury ceilings.

SECONDARY HOME MORTGAGE MARKET ACTIVITY

Period	FNMA auctions of forward purchase commitments: Conventional: Amount ($ millions) Offered	Conventional: Amount ($ millions) Accepted	Conventional: Yield to FNMA[1]	Government-underwritten: Amount ($ millions) Offered	Government-underwritten: Amount ($ millions) Accepted	Government-underwritten: Yield to FNMA[1]	Yields on GNMA-guaranteed mortgage-backed securities for immediate delivery[2]
1979--High	454	172	13.97	1,035	448	13.29	12.10
Low	19	18	10.92	37	19	10.42	9.51
Dec. 3							11.29
10	207	73	12.98	305	119	12.42	11.18
17							11.49
26	206	80	12.99	344	131	12.55	11.39
31							11.39
1980--Jan. 7	220	133	13.10	199	100	12.70	11.63
14							11.51
21	223	114	13.29	317	132	13.11	11.92
28							12.10

1. Average gross yield before deducting fee of 38 basis points for mortgage servicing. Data, based on 4-month FNMA purchase commitments, reflect the average accepted bid yield for home mortgages, assuming a prepayment period of 12 years for 30-year loan without special adjustment for FNMA commitment fees and related stock requirements. Mortgage amounts offered by bidders relate to total eligible bids received.
2. Average net yields to investors assuming prepayment in 12 years on pools of 30-year FHA/VA mortgages carrying the prevailing ceiling rate on such loans.

loans at comercial banks reached the highest level in four years, though well below the record highs of 1974 and 1975, and the delinquency ratio for bank credit card accounts moved up sharply to a new high in September. The percentage of loans delinquent at major automobile finance companies was little changed, however, after the pronounced rise during the second quarter.

Home mortgage delinquencies, as reported to the Mortgage Bankers Association, presented a mixed picture in the third quarter. The percentage of home mortgage loans delinquent 60 days or more was little changed from the second quarter, but there was a large rise in 30-day delinquencies that may presage increases to come in the critical 60-day-and-over category. The Federal Home Loan Bank Board series on mortgage loans delinquent 60 days and over increased somewhat in December after having remained flat in October and November.

CONSUMER INSTALLMENT CREDIT[1]

	1977	1978	1979 Q3	1979 Q4p	1979 Nov.r	1979 Dec.p
Total						
Change in outstandings						
Billions of dollars	35.3	44.8	37.3	26.1	28.9	23.2
Percent	18.2	19.4	12.8	8.6	9.5	7.6
Bank share (percent)	52.9	53.1	32.7	22.6	11.8	21.6
Extensions						
Billions of dollars	254.1	298.4	332.3	320.5	317.6	311.7
Bank share (percent)	46.4	47.8	45.9	44.9	44.4	44.3
Liquidations						
Billions of dollars	218.8	253.5	294.9	294.4	288.7	288.5
Ratio to disposable income	16.8	17.4	18.0	17.5	17.2	17.0
Automobile Credit						
Change in outstandings						
Billions of dollars	15.2	19.6	12.1	6.0	6.4	5.6
Percent	22.5	23.6	11.0	5.4	5.6	4.9
Extensions						
Billions of dollars	75.6	89.0	94.2	87.2	84.8	84.8

1. Quarterly and monthly dollar figures and related percent changes are seasonally adjusted annual rates.
p--preliminary.
r--revised.

APPENDIX A

A REVISED METHOD FOR CALCULATING THE HIGH EMPLOYMENT BUDGET

As a result of a joint staff project by representatives of the Board, CEA, OMB, Commerce, and Treasury, a new methodology for estimating the high employment budget (HEB) has been adopted by these agencies; it is introduced in this Greenbook as well as in the Council's Economic Report.

The old and new methods differ markedly. The new method starts with estimates of actual receipts and expenditures and then adds to these actuals the calculated revenue and spending increments to actual values that would occur as the gap between actual and potential GNP is closed.[1] In contrast, the previous method does not "build-up" from actuals; rather it attempts to calculate directly the level of high employment receipts and expenditures. Because of the difference in approach, the new method has a number of advantages.

Since the new method adjusts to actual values, it avoids the lack of consistency between the actual and high employment budget sometimes found in the old method. In the latter this problem arose because projections of high employment income shares and tax rates--based largely on historical trends of income shares and tax rates--were unlikely to incorporate fully the projected structural changes in the economy that were embodied in forecasts of actual income shares and effective tax rates. As a result of this inconsistent use of information, projections of actual and high-employment receipts would sometimes yield an implausible elasticity of receipts with respect to changes in income between actual and potential GNP.

Such problems are avoided by the new approach, as forecasts of high employment revenues are developed by projecting actual receipts--which reflect new tax legislation and projected structural changes in the economy--and then adding to these receipts the extra revenues that would be collected if the gap between actual and high-employment GNP were closed. Estimates of these additional revenues are based on the historical behavior of income shares and effective tax rates over the business cycle and on projected values for actual and potential GNP. Thus, the additional revenues gained in closing the gap do not include any particular projected structural changes, but high employment revenues--the sum of these additional revenues and projected actual receipts--do include the bulk of such structural changes. Because of this, the implied elasticity of receipts with respect to changes in income between actual and potential GNP is more plausible than under the previous method.

1. The additions to actual values are derived from econometric equations. In the case of personal tax receipts, for example, the additional personal tax revenues associated with a closing of the gap are calculated by applying an estimated 1.33 tax elasticity to the difference between an estimated value for high employment adjusted personal income (based on an income share equation) and an estimated value for actual adjusted personal income (based on the same income share equation).

Another advantage of the new method, on the receipts side, is its relatively heavy use of actual receipts, while estimates of variables like high employment GNP and income shares are only used in the calculation of adjustments to actual values, or "gross-ups," not in the calculation of high employment receipts per se. In contrast, the prior method abstracted completely from actual receipts, using only variables inherently difficult to estimate such as real GNP, income shares, and effective tax rates, all evaluated at a hypothetical high employment level of economic activity.

A comparison of the HEB estimates resulting from each method for the forecast period are presented in table 1. In this comparison, the two series are based on the same assumptions about income shares, tax elasticities, and the economy. As can be seen, the levels of the HEB using the new method tend to lie below those using the old method. However, the changes tend to move together, providing essentially the same impression about the direction or thrust of fiscal policy. Both series indicate a substantial move toward fiscal restraint in the coming two years. This restraint is due in large part to the imposition of the windfall profits tax, increase in social security taxes, and the interaction of inflation with the progressive personal income tax structure.

In addition to developing an improved approach for calculating the HEB, much work has been done on improving estimates of its underlying components such as income shares, effective tax rates, and tax elasticities. In addition, cyclical adjustments of expenditures have been made for several federal expenditure programs in addition to unemployment insurance. A brief technical description of this work comprises the remainder of this Appendix.

Estimates of Income Shares

In the past, estimates of full employment income shares have been based on an interpolation between share values in actual full employment periods. In contrast, under the new approach each share is specified as a linear function of time and current and lagged values of the percentage GNP gap. Such equations--explaining the shares of all major components of national income[1] and also the difference between GNP and national income--are then jointly estimated. This estimating procedure guarantees that the shares sum to 100 percent of GNP and that the sum of the gaps between estimated actual and high employment values for income components equals the gap between actual and potential GNP. One important result revealed by the analysis is that as the GNP gap is closed approximately 20 percent of the increased income is allocated to corporate profits and 75 percent to compensation of employees.

1. The major components of national income explicitly considered are wages and salaries, other forms of compensation, nonfarm proprietors' income, farm proprietors' income, corporate profits, and rent plus net interest.

Estimates of Tax Elasticities and Rates

Much effort was made to improve existing estimates of the personal income tax elasticities. An inter-period elasticity is used in estimating actual personal receipts over time and captures the effects on tax receipts of both inflationary and real income gains. In contrast, an intra-period elasticity is used in calculating at a point in time the extra revenues associated with a closing of the gap between the estimated actual and high employment levels of adjusted personal income. In order to control only the path of real economic activity, closing of this gap is assumed to involve no change in the price level; this means that the intra-period elasticity captures the effects on receipts of only real income gains due, for example, to increases in employment, hours worked, and productivity.

To estimate these elasticities both time series and cross-sectional analyses were employed. The time series analyses related personal tax receipts--adjusted for changes in the relevant tax law--to adjusted personal income, with many functional forms and sample periods tried. This analysis tended to support the 1.45 personal income tax elasticity underlying past projections of actual receipts. The cross-sectional analysis utilized the "tax-file model" of the Department of the Treasury's Office of Tax Analysis. Analysis using this model was performed for several years in the 1970s. It required estimates of changes in both employment and the components of adjusted personal income that would occur with a closing of the GNP gap. The former was derived using the CEA's potential GNP model and the latter from the analysis of income shares. Further, the model required estimates of the productivity, income distribution, and filing status of the extra employed persons, with the results of the exercise particularly sensitive to these factors. A final value of 1.33 was chosen for the intra-period personal income tax elasticity.

The marginal corporate tax rate used in the calculation of the additional corporate tax revenues gained in closing the gap was derived using time series analysis. An equation was estimated relating federal corporate profits tax receipts (net of Federal Reserve System profits) to a profits tax base (adjusted for Federal Reserve System profits, profits from the rest-of-the-world sector, and state and local corporate tax payments) and the investment tax credit. The estimated relation was very precise and implied a marginal corporate tax rate around 40 percent in recent years.

Calculation of the additional contributions for social insurance associated with closing the GNP gap involved an examination of the disaggregated components of these contributions.[1] This disaggregated

1. The disaggregated components were social security taxes excluding those paid by the self-employed and railroad retirement taxes; social security contributions by the self-employed; unemployment insurance taxes; and other taxes (including federal employee retirement contributions, supplemental medical insurance premiums, veterans life insurance payments, and workmen's compensation).

approach was thought important because social security taxes have increased since the 1950s to a major fraction of total receipts.

The analysis involved estimation of separate tax bases and tax elasticities for each category (except other taxes, which was assumed to be noncyclical). The tax bases were derived from estimates of income shares and the proportion of income generated by employees covered by each program. The tax elasticities--capturing the sensitivity of social insurance contributions to changes in earnings--were computed as a weighted average of an employment elasticity (assumed to be 1.0 as the gap closes) and an average wage elasticity (based on simulations of the Social Security Administration revenue estimating model). For example, the elasticity for social security taxes with respect to wage increases (excluding those paid by the self-employed) was around .80 in 1979, having increased from .60 in 1970 because of the sizable increase in the taxable earnings base relative to average earnings over the period. As a result the weighted tax elasticity has risen from around .80 to .90 over the same period, where the weights were based on the proportion of the increase in wages and salaries in closing the gap attributable to the associated increase in average wages (due, for example, to gains in productivity or hours) and employment.

Indirect business taxes are comprised of specific and ad valorem excises, customs duties, and nontax accruals, with specific excise taxes amounting to over half the total. Calculation of the responsiveness of these taxes to changes in real GNP was based on commodity demand studies. According to these studies, most of the taxes are on products for which demand is inelastic with respect to income,[1] implying that the elasticity of total indirect business taxes with respect to real GNP is less than unity. Moreover, this elasticity has declined from a value of .84 in 1955 to .63 at present due largely to the repeal of many cyclically sensitive excise taxes, such as the automobile excise tax.

Estimates of Expenditure Adjustments

In the past the only expenditure program adjusted for a closing of the GNP gap and the associated reduction in the unemployment rate was regular unemployment insurance benefits. Under the new method cyclical adjustments have also been made for extended unemployment insurance, food stamps, aid to families with dependent children, old age and survivors insurance, disability insurance, medicaid, and veterans benefits.

The adjustment for regular unemployment insurance benefits has been reestimated on the basis of a regression equation relating total benefits to the insured unemployment rate, labor force, and the size

1. Examples of such products are alcohol, tobacco, and fuel.

of average weekly benefits. The results suggest that regular benefits rise around $2.5 billion for each 1 percentage point increase in the unemployment rate. In addition, the cost of extended benefits is estimated to rise smoothly to nearly 100 percent of regular benefits as the unemployment rate rises to 7.5 percent. At rates above 7.5 percent, the cost of extended benefits rises sharply to around twice the cost of regular benefits since several state programs are then triggered into operation. Estimates of the cyclical adjustments for the other expenditure programs mentioned above are based on extensive analysis by many government agencies on the cyclical sensitivity of these programs to changes in the unemployment rate. Expenditures on these programs are estimated to increase by around $1 billion for every percentage point rise in the unemployment rate above the benchmark rate of 5.1 percent.

This Appendix was prepared by Darrel Cohen, Economist, Government Finance Section in the Division of Research and Statistics.

Comparison of High Employment Surplus Estimates Using Old and New Methods
(billions of dollars)

FES	1979:4	1980:1	1980:2	1980:3	1980:4	1981:1	1981:2	1981:3	1981:4	FY'79	FY'80	FY'81	1979:4 to 1980:4	1980:4 to 1981:4
Old	13.0	17.2	24.1	21.6	36.4	65.1	67.1	75.8	83.5	4.0	19.0	61.1	23.4	47.1
New	12.6	6.6	13.2	12.5	30.4	60.2	73.8	74.1	83.4	4.3	11.2	59.7	17.8	53.0

Foreign exchange markets

The weighted-average foreign exchange value of the dollar is slightly higher than its value at the end of 1979; the dollar declined about 1 percent in the first week of January, but it has risen steadily since to recoup its earlier losses. The political and economic uncertainties arising from developments in Iran and Afghanistan continue to dominate exchange markets, and rate movements in particular currencies have often been volatile. Some commodity markets have also been affected, and the gold price skyrocketed to over $850 per ounce at one point, but has since dropped back to around $700.

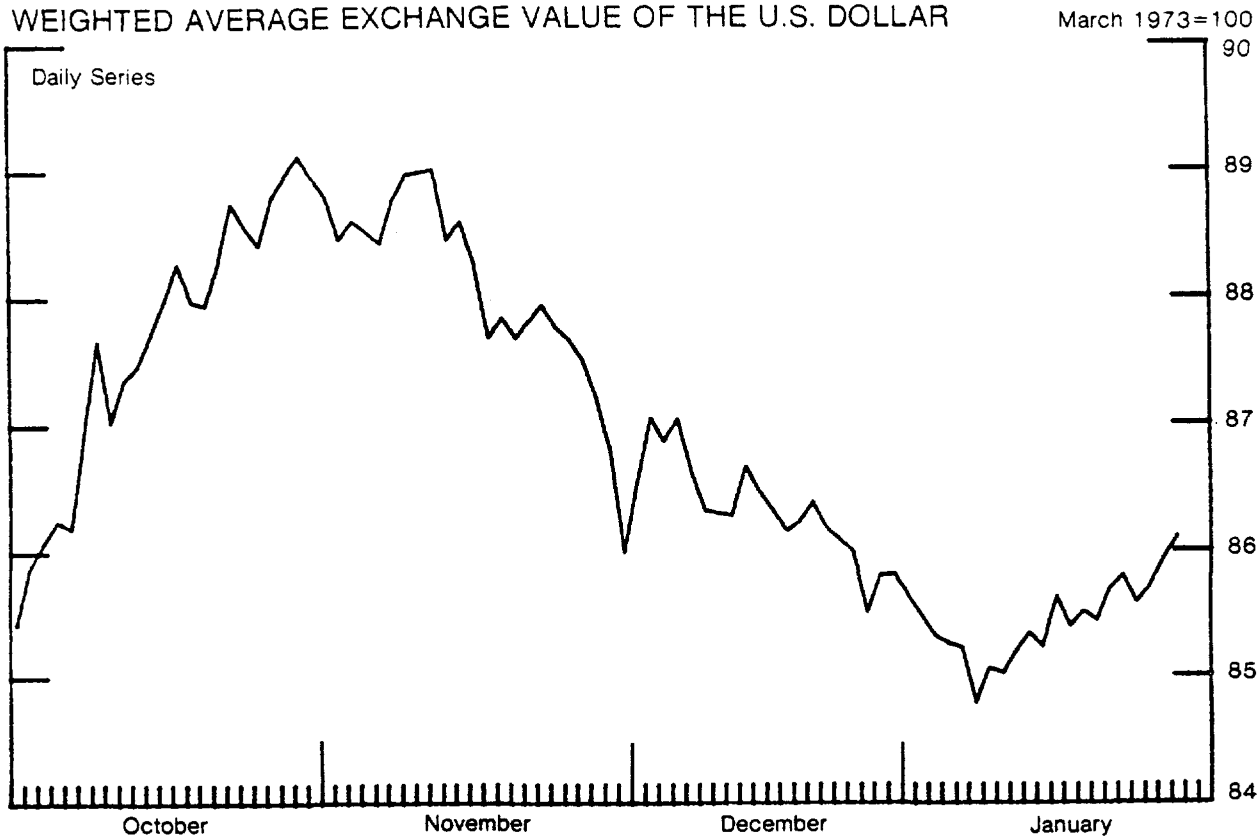
In foreign exchange markets the yen has shown the largest daily fluctuations and has moved over a wide range, but it is currently trading at its year-end level. The pound has experienced daily fluctuations of nearly 1 percent during this period but has generally moved higher to a level nearly 2 percent higher than at year-end. The EMS currencies, including the mark, are generally about 1/2 percent lower than at year-end.

. The Bank

of Sweden

on January 18, raised its discount rate 1 percentage point to 10 percent citing external considerations.

WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR



. In late January, the System also repaid its small Swiss franc swap debt.

OPEC surpluses and investment flows in 1979. The OPEC current account surplus is estimated to have risen from $7 billion in 1978 to $65 billion in 1979 as a result of the steep increase in oil prices. (A still larger surplus of about $110-115 billion is currently being projected for 1980, in consequence of the further oil price increases in late 1979 and early 1980.) OPEC oil revenues rose from $130 billion in 1978 to about $200 billion last year. OPEC imports, in contrast, rose only about 4 percent in 1979, to an estimated $104 billion, the small rise resulting from slower growth of economic activity and import demand in some countries and from a precipitous drop in imports in Iran. The OPEC deficit on net services and private transfers continued to widen quite rapidly, but in absolute terms that rise was dwarfed by the increase in oil revenues. The bulk of the current-account surplus was concentrated in the second half of the year, in reflection of the especially sharp oil price increases between April and July 1, and is estimated to have run at a quarterly rate of around $20 billion in each of the final two quarters.

OPEC external investment flows which can be identified amounted to about $24-1/2 billion in the first three quarters of 1979, equal to 55 percent of the current account surplus in the same period. Reported investments in the United States, the United Kingdom, the Eurocurrency market, other bank deposits, and international organizations came to only $3.7 billion in the first two quarters but increased to almost $21 billion in the third; a relatively small part of that increase can be attributed to the lag in payments for oil exports. For the nine months,

ESTIMATES OF OPEC CURRENT ACCOUNT AND EXTERNAL INVESTMENTS
(Billions of dollars)

	1978 Year	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Year
Current account						
1. Exports	141	38.5	47.5	61	65	212
(Oil)	(130)	(36)	(45)	(58)	(62)	(201)
(Non-oil)	(11)	(2.5)	(2.5)	(3)	(3)	(11)
2. Imports	100	19.5	21.5	29	34	104
3. Trade balance (1-2)	41	19	26	32	31	108
4. Net services and private transfers	-31	-9	-10	-10	-10	-39
5. Public transfers	-3	-1	-1	-1	-1	-4
6. Current account balance (3 + 4 + 5)	7	9	15	21	20	65
External investments					Oct.	
1. In United States	.9	-1.9	.7	2.0[2]	1.5[2]	
a. Treas. bills & bank deposits	-.1	-.8	1.4	1.6	1.2	
b. Other securities	.1	-1.0	-.6	.4	.3	
c. Other capital flows[1]	.8	-.1	-.1	n.a.	n.a.	
2. In United Kingdom	.2	.4	.4	.8	n.a.	
a. Liquid sterling assets	.1	.4	.4	.7	n.a.	
b. Other loans & investments	.1	0	0	.2	n.a.	
3. In Eurocurrency market[3]	3.0	3.6	.8	18.5	n.a.	
4. Int'l. organizations	.1	-.2	-.1	-.4	n.a.	
Subtotal	4.2	1.9	1.8	20.9	n.a.	
5. Other investments & net borrowings (or repayments)[4]	2.8	7.1	13.2	.1	n.a.	

Note: Numbers may not add to total because of rounding.
1. Including direct investment, prepayments for U.S. exports, and deposits with nonbanks.
2. Incomplete totals.
3. Including domestic currency bank deposits outside the United States and United Kingdom.
4. Including credit to oil companies reflecting payments lag.

additions to OPEC Eurocurrency deposits, as well as to domestic-currency deposits outside the United States and United Kingdom, totaled close to $23 billion, accounting for the great preponderance of the identified investments and amounting to one-half of the surplus. Investments in the United Kingdom came to $1.6 billion and those in the United States to less than $1 billion (although third-quarter data are incomplete). Following a net liquidation of their assets in the United States in the first half of the year, the OPEC countries increased their holdings in the United States by at least $3.5 billion in the four months July-October. However, these increases were a rather modest share of the total worldwide OPEC investment flows, and partial data for the rest of the year do not suggest much if any pick-up in the share of total OPEC investments flowing to the United States.

U.S. International Transactions

The trade data for December are not yet available on an international accounts basis. On the census basis, the trade deficit for the fourth quarter was about the same as the deficits in the second and third quarters. For the year as a whole the deficit was down somewhat from 1978.

Petroleum imports rebounded to 8.9 mbd in December from 7.9 mbd in November (including imports into the U.S. Virgin Islands). The average for the fourth quarter, 8.7 mbd, was about the same as for the second and third quarters. The price of imported oil climbed about 8 per cent in December, to approximately $25 per barrel. Since the mid-December Caracas meetings, the only change in the OPEC price picture has been the $2 per barrel increase, retroactive to January 1, announced January 28 and 29 by Saudi Arabia, Kuwait, U.A.E., Qatar and Iraq. In contrast to official contract prices, spot prices have been slipping. The gap between spot and contract prices has fallen to the $3 to $8 per barrel range from the pre-Caracas range of $15 to $20 per barrel. The amount added to U.S. average import prices by spot market purchases is likely to be smaller in January than in the fourth quarter.

Agricultural exports are expected to total a record $37 billion in 1980, despite the embargo on grain exports to the Soviet Union. The embargo is expected to have several secondary repercussions, in addition to the direct loss of export sales to the Soviet Union. There is likely to be distress slaughter of Soviet livestock because of the lack of replacements for U.S. feedgrains. This will reduce world demand for feedgrains for several years. On the other hand, the Soviets will have little difficulty making up for the loss of U.S. wheat from other sources. The volume of U.S. wheat exports is likely to drop by only a fraction of the lost sales to the Soviet Union because slightly lower prices will also encourage sales to other countries. The forecast for agricultural exports for 1980 has been revised downwards by about $2 billion due to the embargo.

Turning to the capital accounts, the pattern of private and official capital flows in November was similar to the pattern in October and in the first half of 1979. Large net official outflows were accompanied by large net private inflows.

Official reserve holdings of the G-10 countries and Switzerland in the United States fell by almost $8 billion in November. Japan sold dollars heavily to support the value of the yen. German holdings fell sharply because the Bundesbank engaged in liquidity tightening foreign exchange swaps with German commercial banks. In December and early January several swaps originally designed to tighten liquidity matured and new swaps were arranged to ease German money market conditions. As a result German official holdings at the FRBNY went up again by about the same amount.

In November, OPEC holdings of official reserve assets in the United States increased by $1.9 billion; in October they had increased $1.7 billion. The net increase in OPEC assets in the U.S. during these months was only about half this size. The rest was the result of a transfer of funds to the FRBNY from a special Treasury account.

U.S. reserve assets rose by $1.3 billion in November, chiefly because of the Treasury's issue of mark-denominated notes. The sale of

RESTRICTED

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

	1977 Year	1978 Year	1978 Q4	1979 Q1	1979 Q2	1979 Q3	1979 Sept.	1979 Oct.	1979 Nov.
1. Trade balance 1/	-30,873	-34,187	-6,369	-6,115	-7,716	-7,282	-3,144	-2,383	-2,004
2. Merchandise exports	120,816	141,884	39,315	41,348	42,792	47,337	15,500	17,318	16,841
3. Merchandise imports	-151,689	176,071	-45,684	-47,463	-50,508	-54,619	-18,644	-19,701	-18,845
4. Change in net foreign positions of banking offices in U.S. (excl. liab.to foreign official inst.)	-3,909	-14,924	-13,697	14,681	4,798	617	-7,801	3,713	3,875
Through interbank transactions with									
5. a) Own offices in foreign countries	-2,718	4,940	-3,221	15,327	6,753	8,148	-7,044	538	-2,065
6. b) Unaffiliated banking offices in foreign countries	-2,204	-4,520	-6,423	818	-1,266	-2,310	3[illegible]	4,267	4,950
Through nonbank transactions									
7. a) Claims on nonbanks in foreign countries (increase,-)	-424	-16,431	-4,829	-1,006	-2,017	-5,306	-1,292	-1,442	152
8. b) Liabilities to private nonbanks in foreign countries (inc. custody liab.)	1,436	1,089	776	-458	1,327	84	213	350	838
9. Private securities transactions,net (excl. U.S. Treas. Oblig.)	-3,068	-688	-116	-537	-77	-1,970	-941	-116	-490
10. Foreign net purchases of U.S. corp. bonds	1,112	1,117	506	*	278	6	105	165	-123
11. Foreign net purchases of U.S. corp. stocks	1,326	1,686	297	424	274	142	17	-8	53
12. U.S. net purchases (-) of foreign securities	-5,506	-3,491	-919	-961	-629	-2,118	-1,063	-273	-420
13. Foreign net purchases of U.S. Treasury obligations 2/	534	2,251	1,546	2,564	-239	1,579	55	36	1,079
14. Change in foreign official reserve assets in U.S. (increase +)	35,448	31,471	16,853	-8,257	-10,293	5,747	1,195	-3,063	-5,302
By Area									
15. G-10 countries and Switzerland	29,414	29,955	15,574	-7,101	-11,613	4,808	1,016	-3,526	-7,952
16. OPEC	5,743	-1,074	1,073	-1,645	248	1,761	-510	1,740	1,882
17. All other countries	291	2,590	206	489	1,072	-822	689	-1,277	768
By Type									
18. U.S. Treasury securities	30,266	23,869	13,309	-7,965	-12,799	5,036	796	-2,430	-7,071
19. Other 3/	5,182	7,602	3,544	-292	2,506	711	399	-633	1,769
20. Change in U.S. reserve assets (increase -)	-237	662	200	-3,008 4/	446	2,712	1,489	540	-1,267
21. All other transactions and statistical discrepancy	2,105	15,416	1,583	672	13,081	-1,403	9,147	1,273	4,109
MEMO: Current Account (bil. $. seasonally adj., annual rates)	-14.1	-13.5	.3	1.7	-4.2	3.0	n.a.	n.a.	n.a.

1/ International accounts basis, seasonally adjusted.
2/ Includes U.S. Treasury notes publicly issued to private foreign residents.
3/ Includes deposits in banks, commercial paper, bankers' acceptances, and borrowing under repurchases agreements.
4/ Includes $1,103 million of newly allocated SDR's.
*/ Less than $500,00.

Carter notes is also reflected in foreign net purchases of U.S. Treasury obligations in November. An additional $1.2 billion equivalent of DM Carter notes were issued in January.

Private capital flows reported by banking offices in the United States showed a net inflow of $3.9 billion in November. The net inflow was more than accounted for by a reduction in banks' loans to unaffiliated banking offices abroad. After October 6, the U.S. agencies and branches of foreign banks ran down their loans to non-affiliated foreign banks and probably made them instead from their offices outside the United States. Partial data for December and early January indicate that this process has now stopped.

U.S. banks reduced their net liabilities to affiliated foreign offices by over $2 billion in November; partial data for member banks indicated that net liabilities continued to decline in December. Thus it appears that U.S. banks did not fund additional domestic credit activities from related offshore branches in the fourth quarter. This is in sharp contrast to the first three quarters of the year, when net liabilities to foreign offices (Eurodollar borrowings) increased by $25 billion.

U.S. non-bank holdings of Eurodollar deposits reported by foreign branches of U.S. banks have leveled off since August, after growing by $10 billion in the first eight months of 1979. They totaled $28 billion at the end of November. Eurodollar CD holdings of open-ended money-market mutual funds and short-term unit investment trusts continued to grow in December and January, reaching $8.3 billion by the middle of the latter month.

An informal survey of several brokerage houses indicates that net foreign purchases of U.S. equities in the last two months of 1979 and early 1980 may have been fairly substantial. Foreign buying appears to have been strongly motivated by international political developments and has not lagged behind the rise in U.S. stock market prices as it frequently has in the past.

Foreign economic developments. In most major foreign industrial countries continued strength characterized economic activity during the fourth quarter of 1979. Industrial production for October-November was up in Germany, Japan, the United Kingdom and Italy, although it fell in Canada and in France. In Germany, preliminary official estimates show real GNP growth of 5 percent (a.r.) in the fourth quarter and places year-over-year growth for 1979 at 4.4 percent. These indicators suggest that the momentum of economic growth leading into 1980 may be greater than expected.

Inflation continued at a rapid pace in the major industrial countries. Price increases accelerated in Germany and Japan at the end of last year; in Italy, prices advanced sharply in January, reflecting largely the pass-through of recent oil price hikes.

A notable development in 1979 was the sharp drop in the combined merchandise trade surpluses of major foreign countries -- for the six major countries the trade surplus dropped from $46 billion in 1978 to an estimated $4 billion in 1979. The higher price of imported oil was the principal cause of the huge declines in trade balances for Japan, Germany, and France. In Italy, increases in imports, as well as higher oil prices, resulted in an enlarged deficit. Trade surpluses in 1979 also declined relative to 1978 levels in the United Kingdom, despite a reduction in the degree of dependence on imported oil and in Canada, where less than 10 percent of oil consumption is imported. In the United Kingdom, appreciation of the pound earlier in the year and rising real wages served to weaken non-oil exports and led to a significant increase in imports, while a decline in auto exports to the United States was a major item in the lower Canadian surplus.

REAL GNP AND INDUSTRIAL PRODUCTION IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change from previous period, seasonally adjusted)

					1978	1979				1979					
		1977	1978	1979	Q4	Q1	Q2	Q3	Q4	Jul.	Aug.	Sept.	Oct.	Nov.	Dec.
Canada:	GNP	2.4	3.4	n.a.	0.7	1.6	-0.7	1.3	n.a.	*	*	*	*	*	*
	IP	4.0	5.3	n.a.	2.6	1.4	-1.2	2.3	n.a.	2.4	-0.2	2.4	-1.1	-0.4	n.a.
France:	GDP	3.0	3.5	n.a.	1.9	-0.2	0.5	1.8	n.a.	*	*	*	*	*	*
	IP	2.0	1.9	n.a.	1.8	0.0	0.5	4.1	n.a.	3.8	0.0	-0.7	-2.9	1.5	n.a.
Germany:	GNP	2.6	3.5	n.a.	0.8	0.4	2.0	1.1	n.a.	*	*	*	*	*	*
	IP	2.6	2.3	n.a.	0.8	-0.3	3.4	1.9	n.a.	3.2	-3.9	0.8	0.8	0.8	n.a.
Italy:	GDP	2.0	2.6	n.a.	2.9	1.1	-0.7	1.0	n.a.	*	*	*	*	*	*
	IP	1.1	1.9	n.a.	6.1	1.1	-2.6	1.1	n.a.	3.2	-0.1	6.4	3.8	0.1	n.a.
Japan:	GNP	5.4	6.0	n.a.	1.6	1.5	1.7	1.8	n.a.	*	*	*	*	*	*
	IP	4.2	6.2	n.a.	2.2	1.8	2.4	2.0	n.a.	1.1	0.9	-1.5	2.6	1.2	n.a.
United Kingdom:	GDP	2.0	2.7	n.a.	-0.1	-1.0	3.7	-1.9	n.a.	*	*	*	*	*	*
	IP	3.8	3.8	n.a.	-1.1	-0.7	5.5	-2.3	n.a.	-1.0	-4.0	-0.9	1.5	1.1	n.a.
United States:	GNP	5.3	4.4	2.3	1.4	0.3	-0.6	0.8	0.4	*	*	*	*	*	*
	IP	5.9	5.8	4.1	1.9	1.0	-0.2	0.2	-0.1	0.1	-0.8	0.5	-0.1	-0.3	0.3

* GNP data are not published on monthly basis.

CONSUMER AND WHOLESALE PRICES IN MAJOR INDUSTRIAL COUNTRIES
(Percentage change, from previous period or as indicated)

		1977	1978	1979	1978		1979				Latest 3 Months from:		
					Q3	Q4	Q1	Q2	Q3	Q4	Previous 3 Months (at Ann. Rate)	Year Ago	Latest Month
Canada:	CPI	8.0	8.9	9.1	2.5	1.6	2.3	2.6	2.0	2.3	9.5	9.5	Dec.
	WPI	7.9	9.2	n.a.	2.1	3.3	4.9	3.1	2.7	n.a.	15.2	14.8	Nov.
France:	CPI	9.5	9.2	10.6	2.7	2.1	2.2	2.8	3.2	2.8	11.8	11.5	Dec.
	WPI	5.6	4.3	13.3	1.9	2.9	4.4	3.8	2.8	1.8	7.5	13.4	Dec.
Germany:	CPI	3.9	2.6	4.3	0.0	0.1	2.1	1.6	1.2	0.8	3.3	5.7	Dec.
	WPI	1.8	-0.3	n.a.	-0.6	0.1	3.4	3.3	1.7	n.a.	3.8	9.8	Nov.
Italy:	CPI	18.4	12.1	14.8	2.4	3.0	3.8	3.7	3.5	5.5	23.9	17.6	Dec.
	WPI	17.4	8.4	n.a.	1.8	2.2	4.4	4.6	4.3	n.a.	24.2	19.1	Nov.
Japan:	CPI	8.3	4.3	3.5	0.8	0.2	-0.2	2.2	0.9	1.9	7.1	5.6	Jan.
	WPI	1.9	-2.5	7.3	-1.7	-0.6	1.9	4.1	4.9	3.3	18.3	16.0	Dec.
United Kingdom:	CPI	15.8	8.3	13.4	1.7	1.7	3.1	3.7	6.7	2.8	11.7	17.3	Dec.
	WPI	19.8	9.1	12.2	1.9	1.7	2.7	4.0	5.0	2.9	12.2	15.4	Dec.
United States:	CPI	6.5	7.6	11.3	2.4	2.0	2.5	3.4	3.3	2.9	12.2	12.7	Dec.
	WPI	6.1	7.8	12.5	1.5	2.3	3.6	3.6	3.1	3.4	14.4	14.4	Dec.

TRADE AND CURRENT-ACCOUNT BALANCES OF MAJOR INDUSTRIAL COUNTRIES[a]
(Billions of U.S. dollars; seasonally adjusted)

	1978	1979	1978 Q3	1978 Q4	1979 Q1	1979 Q2	1979 Q3	1979 Q4	1979 Oct.	1979 Nov.	1979 Dec.
Canada: Trade	3.1	3.0[e]	0.6	0.7	0.6	0.6	0.8	n.a.	0.3	0.4	n.a.
Current Account	-4.6	n.a.	-1.2	-1.5	-1.2	-1.3	-1.0	n.a.	*	*	*
France: Trade[b]	0.6	-2.3	0.2	0.0	0.3	-0.4	-1.4	-1.2	-0.7	-0.3	-0.2
Current Account[b]	3.7	2.4	0.9	1.3	0.6	0.7	0.1	0.5	*	*	*
Germany: Trade	20.6	13.0[e]	5.4	5.6	4.3	3.8	2.4	n.a.	0.4	0.9	n.a.
Current Account[c]	8.9	n.a.	0.2	4.8	1.4	-1.1	-4.2	n.a.	-0.4	-0.5	n.a.
Italy: Trade	-0.2	-5.0[e]	-0.8	0.5	-0.4	-0.7	-1.2	n.a.	0.0	-2.1	n.a.
Current Account[c]	6.4	n.a.	2.5	1.7	1.1	2.1	n.a.	n.a.	*	*	*
Japan: Trade	24.6	2.0	6.8	4.2	2.6	1.8	-0.9	-1.5	-0.5	-0.7	-0.3
Current Account	16.5	-8.6	4.5	1.7	0.3	-0.7	-3.8	-4.2	-1.2	-1.7	-1.3
United Kingdom: Trade[d]	-2.9	-6.9	-0.8	-0.2	-3.2	-1.4	-0.9	-1.2	-0.9	-0.1	-0.2
Current Account[d]	1.4	-5.1	0.6	1.2	-2.4	-1.3	-0.5	-0.7	-0.6	0.0	0.0
Major Countries, Trade Balance	46.2	3.8[e]	11.4	10.8	4.2	3.7	-1.2	n.a.	-1.4	-1.9	n.a.
United States: Trade	-33.8	n.a.	-7.9	-6.0	-6.1	-7.7	-7.3	n.a.	-2.4	-2.0	n.a.
Current Account	-13.5	n.a.	-3.2	0.1	0.4	-1.1	0.8	n.a.	*	*	*

a The current account includes goods, services, and private and official transfers.
b French annual data is not seasonally adjusted.
c Not seasonally adjusted.
d U.K. quarterly data do not reflect revisions in annual totals.
* Comparable monthly current account data are not published.
e 1979 totals estimated.

Individual country notes. In Japan, industrial production recorded a substantial increase in October-November compared with the two previous months, suggesting that fourth quarter real growth may have slackened very little from the 6-1/2 percent (a.r.) seen earlier in the year.

The otherwise strong performance of the Japanese economy continues to be plagued by high rates of inflation that have not been moderated so far by tighter monetary policy in 1979. Wholesale prices recorded another large advance in December (the second-largest monthly increase in the past five years), and at year-end the WPI was more than 17 percent above its level in December 1978. Consumer prices have also continued their recent strong rising trend, although the rate of increase has been less dramatic; in the three months ending in January consumer prices rose at about a 7 percent annual rate. In view of recent large increases in the WPI, strong upward pressure on consumer prices is expected to continue in the current quarter, a development that could, if realized, have an adverse impact on spring wage negotiations.

Price factors have dominated recent movements in Japan's external accounts. The 1979 current-account registered a deficit of $8.6 billion, due mainly to higher oil import prices that contributed to a decline of almost 30 percent in Japan's terms-of-trade during the year. The oil import bill rose $10 billion in 1979. The 1979 trade surplus of $2 billion was $22.6 billion lower than in 1978.

In recently announced policy measures the Ohira government seems prepared to continue in 1980 a moderate tightening of policy. The budget for FY1980, which begins April 1, calls for only a 10 percent nominal increase in general-account expenditures, roughly in line with expected nominal GNP expansion, while the government's fiscal loan and investment program will increase by only 8 percent. Both figures are slightly below corresponding rates of increase in the FY1979 budget. The authorities have also forecast a 10 percent rate of growth of M-2 in the current quarter, a one percentage point decline from the fourth-quarter rate.

In Germany, industrial production for October-November rose relative to the preceeding two-month period. This was consistent with strong GNP growth in the fourth quarter. However, the rate of unemployment, after having reached a five year low at 3.6 percent in September through November, inched up to 3.7 percent in December.

Wholesale prices are currently 10 percent above their year-ago level. In December the consumer price index was 5.7 percent over its year earlier level.

Estimates are that the trade surplus for 1979 declined more than $9 billion relative to its 1978 level; a change that is accounted for by the 1979 increase in Germany's oil bill of $10 billion.

Economic activity in Italy in the fourth quarter maintained its vigorous recovery from mid-year strikes. Industrial production in October-November averaged 10.5 percent higher than the July-August level. The major source of strength appears to have been private domestic demand, both in the form of business stockpiling as well as strong consumer demand. Consumer spending may have been sustained by a growth of disposable income brought about by last year's contract wage increases and the more frequent indexation of government workers' salaries.

Consumer price inflation in November-December decelerated from its very high pace of the previous two months, although it still averaged about 1.5 percent per month. However, early indications for January point to an increase of 2.5 to 3 percent, reflecting to a major extent a sharp rise in fuel prices. The government recently announced price increases for a wide range of petroleum products as well as increases in public utility charges.

In November the trade deficit (s.a.) jumped to $2 billion after averaging $300 million per month in August-October. Imports rose substantially in value terms while export values dropped; these movements may reflect the strength of fourth-quarter activity.

In the United Kingdom, higher industrial production in October and November and a rise in the volume of retail sales above the level of the third quarter suggest that the level of real output probably increased in the final quarter of 1979. Anticipation of the strike currently under way against the British Steel Corporation may have boosted fourth-quarter growth.

Real GDP in France rose by an unexpectedly high 8 percent (s.a.a.r.) in the third quarter. However, industrial production for October-November fell relative to the previous two months indicating that this high rate of GDP growth probably did not continue in the fourth quarter.

On January 1, retail and wholesale price margins were decontrolled on all goods except fresh food; industrial prices were freed in 1978 and controls on service prices will be lifted in stages. However, the government has pledges from large store groups and other sectors to freeze prices voluntarily for two to three months. Higher social security rates were also introduced January 1. On January 2, the government reacted to the year-end oil price increase -- the increased oil price will be passed on immediately and will be reflected in electricity and gas prices, while the impact on the lowest income recipients will be offset by a special payment in late February. About $2 billion will be made available in credits in 1980 for investments targeted for energy conservation, exports, and employment creation; the amount is about one-quarter of the estimated increase in the French oil bill.

Industrial production in Canada declined in both October and November -- indicating that the economy may have begun to slow during the fourth quarter. However, unemployment dropped to 7.1 percent in December after averaging 7.4 percent during the previous two months.

The merchandise trade balance (s.a.) increased in November to a surplus of almost $450 million from about $300 million in October. The increased surplus reflected a larger decline in imports than in exports, which may be a consequence of weakening economic activity. For the first 11 months of 1979, the trade surplus (s.a.) was $2.8 billion compared with a surplus of $3.3 billion for the comparable period in 1978. An increase in the Canadian trade deficit with the United States in automotive products in 1979 of more than $1.4 billion compared with 1978 levels was a major item in the lower overall trade surplus.

On December 28, the Bank of Canada announced a new target range of 5 to 9 percent for the annual growth of M-1 from its average level in the second quarter of 1979. The previous range was 6 to 10 percent from a June 1978 base. On February 18, parliamentary elections will be held.

The December CPI in Sweden was about 10 percent above its year-earlier level, compared with a 6 percent increase over the 12-month period ending in June. Most of the acceleration is attributable to increases in energy prices and indirect taxes -- including higher taxes on energy products.

The Swedish government recently proposed its 1980/81 budget in which the growth rate of expenditures was halved, due to declines in subsidies to industries and to a fall in the unemployment rate. Despite the reduction in expenditure growth, the new budget deficit will be equal to 10.5 percent of GNP, which is unchanged from the share of GNP claimed last year.

The Danish government, confronted by a rate of inflation of about 10 percent during 1979, a persistent current-account deficit, and a foreign debt equal to 20 percent of GNP, proposed a tough incomes policy, which was quickly compromised. It now appears that hourly wages in 1980 will rise by about 10 percent, equal to the increase in 1979. Some progress was reported in the government's attempt to reduce the weight of energy prices in the index to which wages are linked.