SHADOW OPEN MARKET COMMITTEE

Policy Statement and Position Papers

September 17, 1979

1. Draft of Proposed Statement, September 17, 1979
2. Position Papers

    SOMC Position Paper, September 1979 – Karl Brunner, University of Rochester

    Weelky Federal Reserve Report – H. Erich Heinemann, Morgan Stanley & Company

    A Report on Fiscal Policy for the Shadow Open Market Committee – Rudolph G. Penner, American Enterprise Institute

    Economic Projections – Jerry L. Jordan, Pittsburgh National Bank

    Economic Prospects Through 1980 – Beryl W. Sprinkel, Harris Trust and Savings Bank

    The International Dimension – Wilson E. Schmidt, Virginia Polytechnic Institute

Draft of Proposed Statement
SOMC September 17, 1979

by Allan Meltzer

The country's economic problems are serious and likely to get worse. The country's economic policies are destabilizing and there is a risk that instability will increase.

Government has avoided, delayed and prevented solutions to the long-term problems of inflation and the low growth of productivity. We enter the eighties with a heritage of unsolved problems. Repeated attempts to find quick solutions to past problems has had no lasting benefit but long lasting harm.

The slow economic growth, high inflation, and high unemployment of the past decade cannot be blamed on the oil cartel. Monetary policy caused consumer prices to rise at an average rate of 7% a year in the seventies. Mishandling of the 1974 oil price increase slowed the rate of investment and lowered the growth of productivity. Reliance on wage and price controls and on guidelines reduced the credibility of government without achieving any reduction in the average rate of inflation. Higher costs of government and increased transfer payments raised the tax burden and discouraged productive activity.

Oil price increases made us poorer, but inappropriate government policies compounded the problem. Now, as we adjust to the most recent increases in oil prices, we appear eager to repeat the errors of the past decade.

Problems and Policies in the Early Eighties

The main policy changes affecting the U.S. economy in recent months have been made in Riyadh and Frankfurt, not in Washington. The 60% increase

in the price of oil is a tax, levied abroad, but paid wherever oil is used. The principal monetary action is the rise in interest rates dictated by the Germans' decision to raise interest rates and our decision, in November 1978, to support the dollar.

The increase in the price of oil in 1979 permanently reduced the incomes of the residents in the oil importing countries and increased the incomes in the oil exporting countries. There is no way that the transfer of real income from oil importers to oil exporters can be avoided or recovered as long as the cartel lasts. If we all work as hard and as much as before, we will have less to spend because we must export more to pay for our imports.

The problem for government policy is to minimize the loss of real income while reducing the rate of inflation. Currently, there is no evidence that the administration or the Federal Reserve has developed a rational response to the stagflation that followed the oil shock. The administration has no fiscal plan to reduce the real burden of the shock. They seem immobilized by a mixture of hope and fear -- hope that the unemployment rate will not reach 8% and fear that it soon will. The Federal Reserve, beguiled by the higher interest rates required to support the dollar, misinterprets the thrust of its policy as less inflationary despite the higher growth of money aggregates that add to future inflation.

The proper response to the oil price increase is a reduction in both government spending and taxes. There are two reasons for tax reduction. First, we are poorer -- poorer than before the oil price increase and poorer than we anticipated when we set the levels of government spending and transfers. Second, the entire burden of the oil price increase falls on private consumption and investment unless taxes and government spending are reduced.

Tax reduction without reduction in government spending -- or with increased transfers and government spending -- repeats the mistakes of 1974-78. Then, we paid for the oil and the tax cut by borrowing at home and abroad. Increased borrowing raised real rates of interest, crowded out private capital and reduced the amount of capital per employed worker. Lower capital per worker means lower productivity, slower growth of output and real income. If we repeat the policies of 1974-78, we reduce the prospects for real growth and productivity increases in the eighties.

The proper fiscal response to the oil shock is a prompt reduction of $20-25 billion in government spending and in taxes for households and businesses. The cut in taxes and spending distributes the real loss between all components of domestic spending.

Money cannot replace oil, and monetary policy cannot offset the loss of real income resulting from the oil shock. The attempt to do so converts the one-time increase in the price level into a permanently higher maintained rate of inflation. This is the mistake of 1976 to 1978 and a repetition will bring permanently higher inflation in the eighties. Monetary policy should <u>not</u> seek to offset the one-time increase in the price level resulting from the devaluation of the dollar in 1978 and the oil price increases of 1979.

The Committee believes that the Federal Reserve should not permit excessive concern about currently reported rates of price increase to cause a sudden, large shift to monetary contraction and a repetition of the policy error of 1974-75. A shift to slow money growth now means higher unemployment in 1980 and increases anticipation of another stop-go cycle in the early eighties. That route also leads to higher inflation and slow growth.

The underlying rate of inflation is now between 8 and 9%. If there is no further devaluation of the dollar and no further shock to supply, the rate of price change will fall toward this range in 1980. The reduction from current rates of inflation will occur even if current rates of monetary expansion continue.

What Should Be Done?

For several years, the Committee has urged the Federal Reserve to adopt a policy of steady, pre-announced reductions in money growth. If this policy had been adopted and maintained for the past three years, we would enter the 1980's with low inflation, low market interest rates and less uncertainty about the future. The dollar would not have been devalued in 1978 and some of the oil price increase might have been avoided.

At our most recent meetings, we urged the Federal Reserve to maintain the growth of the monetary base at 8% until August 1979 and to announce a five year program of gradual monetary reduction. The Federal Reserve's highly variable monetary policy achieved the 8% target rate by providing two quarters of excessive expansion and two quarters of slow money growth. The Federal Reserve's practice of using interest rates as a target of monetary policy not only increased the problem of stagflation but also increased the recent variability of interest rates.

To restore stability to the economy and permanently reduce inflation, the growth rate of the monetary base should now be reduced to an annual rate of 7% for the year ending August 1980. Slower monetary expansion accompanied by reduction in real tax burdens and government spending are the best means of lowering inflation and lowering the cost of adjusting to the oil shock.

The effectiveness of these policies will be increased if they are accompanied by a credible, firm commitment to further reductions in money growth and in real tax burdens.

Heightened concern for inflation and rhetoric that makes inflation "the number one priority" raises the prospect of another round of stop and go and another recession. Federal Reserve efforts to manage interest rates increases the risk that the destabilizing policy cycle will be repeated. Another round of this cycle will fix the underlying rate of inflation permanently in the double digit range and will further lower productivity growth.

The mistaken policies of the past ten years can be avoided only if the Congress, the administration and the Federal Reserve adopt medium-term policies to achieve growth and stability in the eighties. This is the test that policy makers face and seem determined to fail.

SOMC POSITION PAPER, SEPTEMBER 1979

Karl Brunner

I. Our Inheritance of Permanent Drift

The Shadow Open Market Committee warned in its first meeting in September 1973 against our drift into permanent inflation. The Committee's concern was motivated by the repeated failures of our policymaking in 1967, 1970 and again in 1972. The monetary authorities abandoned in each case an anti-inflationary policy within less than one year of its initiation. The reversal of monetary policy in the spring of 1972 terminated the gradual decline in the rate of price changes and unleashed a new wave of inflation. From an inflation level below 4% p.a. in the spring of 1972 price movements accelerated to a rate of increase of 10% p.a. measured over the six months ending in the month of our first meeting. The failure was repeated for the fourth time in 1976/77. Inflation had been lowered to 4.5% p.a. in the second half of 1976 as a result of the financial policies pursued in 1974/75. The SOMC recommended at the time that the prevailing course in monetary growth be maintained with a gradual decline of the growth rate over subsequent years. The adoption of our recommendation would have lowered the rate of inflation by this time to at most 3% p.a. and most probably to a lower level.

But actual policy proceeded, in contrast to the anti-inflationary rhetoric of successive chairmen of the Board of Governors, on an entirely different course. Monetary growth substantially increased beyond 1976 and more than doubled the ensuing rate of inflation.

The entrenched failure of US policymaking became most dramatically revealed by the collapse of the dollar on foreign exchange markets. The international repercussions of our inflationary policies ultimately motivated the change in the Administration's attitude expressed by the events of October 24 and November 1 last year. The President's program presented at the time to the public contained however little relevant anti-inflationary substance. The President's message thoroughly disregarded monetary policy. Still the Federal Reserve Authorities lowered the growth rate of the monetary base beyond October 1978 by a large margin. This growth rate measured almost 10% p.a. from the second to the last quarter of 1978. It fell by almost 50% and settled around 5% p.a. between the

end of October last year and the end of March this year. But the stance adopted by the Fed late in October lasted only five months. A reversal occurred in early April and the monetary base shifted to a higher growth path. The rate of growth approximately doubled and reached about 10% p.a. for the interval beginning early April and extending to the end of August. The "basic" rate of inflation, expressed in terms of the GNP deflator, would settle around 9% to 10% p.a. on this monetary track.

II. Ceterum Censeo . . . .

The task confronting monetary policy hardly changed over the past six years. The urgency of the problem substantially increased however. The present track initiated in early April is not compatible with an anti-inflationary policy. The program formulated by the SOMC last March still offers in my judgment the best chance for guiding the US economy at comparatively low social cost to a stable price level. This program requires that the growth rate of the monetary base be ultimately lowered to about 2% p.a. The Committee emphasized most particularly that this reduction be distributed over several years in a series of gradual steps. And most importantly, the Federal Reserve Authorities should publicly announce now the precise nature of this long-range plan. The critical challenge confronting the Fed at this stage is the creation of a credible, predictable and reliable course of anti-inflationary monetary policy. The potentially high social cost associated with an anti-inflationary program resulted dominantly from the erratic inflationary course of our policies over the past fourteen years. The responsiveness of prices to an anti-inflationary policy substantially declines with the likelihood of policy reversals. Monetary decelerations are thus translated into losses of output and rising unemployment. A new approach to policy procedures which raises the sense of longer-run reliability and predictability forms thus a crucial element of an anti-inflationary program. We should also note that the Committee on Banking and Currency in the US House of Representatives and the Joint Economic Committee of the US Congress offered this year very similar recommendations to the Federal Reserve Authorities.

These recommendations are occasionally dismissed with the assertion that "gradualism" has failed. The fact remains however that it was never tried in this country within the last years of inflationary experience. Whatever attempts at gradually lowering monetary growth over time were ever made were usually abandoned within a few quarters.

III. The Specific Proposal

Implementation of the general program for an anti-inflationary policy requires a definite target path for the immediate future and a specification of the magnitude to be addressed. The monetary base is selected as on previous occasions for our purpose. The data are promptly available with comparatively little measurement error. Such errors still blur the money supply data for M_1 and M_2 and render interpretations based on these data uncertain. But the reliability of the data is not sufficient to justify the selection of the monetary base. It is occasionally argued that the monetary base is just the sum of currency held by the public and bank reserves at the Fed adjusted for the changes in reserve requirements. This is indeed true. But the conclusion that therefore it is mostly determined by the public does not follow and is quite false. The base is also equal to the sum of Federal Reserve Credit, the gold stock and a few other items from the consolidated statement of the Fed and the Treasury's monetary account. Any purchase or sale of any assets by the Fed or the Treasury necessarily changes the monetary base. The magnitude of the base is thus determined by the monetary authorities whether they plan this or not. And the public, interacting with the banks, determines within the context of given reserve requirements the distribution of the base between currency and bank reserves. The monetary base thus completely reflects all the relevant actions of the monetary authorities.

This fact, with the quality of the data, is still not sufficient. It is also important that the base systematically dominates, beyond the shorter-run horizons, the movement of M_1 and M_2. We may also look beyond the usual monetary aggregates at nominal GNP. The base velocity V_o listed in table 1 attached to the statement summarizes the link between the monetary base and GNP. This base velocity occurs as the product of the monetary multiplier and a standard velocity expression. The pronounced negative covariance between monetary multiplier and standard velocity produces a variance for base velocity substantially below the variance of standard velocity. There emerges under the circumstances a noteworthy pattern of regularity in the behavior of the base velocity. It follows that a reduction of the rate of growth in the base to 2% p.a. can be reasonably expected to lower the growth of nominal GNP to around 4% p.a. There will be sufficient time and opportunity over the next five years to raise or lower the "ultimate target" level above or below 2% p.a. should the trend growth in V_o notably deviate from the 2% p.a. observed over the post-war period. Any reliable adjustment would of course require a somewhat more responsible and more competent attention to the collection and analysis of relevant data than the Federal Reserve's past history would suggest.

The Shadow Policy Committee proposed last March that the Federal Reserve Authorities should hold the growth rate of the monetary base at 8% p.a. from the third quarter 1978 to the third quarter of 1979. The Committee recognized the shift in policy initiated in October 1978 and approved the direction of the shift. It warned however that the Fed should not lower the growth rate too much and too rapidly. Excessive retardation within a short period seems to raise the likelihood of a sharp reversal. As it happens, as a matter of pure chance, the growth rate observed from the end of August 1978 to the end of August 1979 measures 8.3%. The four quarter retardation of the monetary base proposed by the SOMC has thus been approximately achieved. The execution remains unfortunately at a remarkably poor level of performance and continues to aggravate the pervasive unpredictability of the Federal Reserve's course. It would appear at this point that the target path for the next four quarter periods, i.e. from III/1979 to III/1980, should be lowered by another notch. I propose therefore that the growth rate of the monetary base be set at 7% over this period. Two caveats should be entered however. This move need be made first as an integral part of a fully articulated policy of anti-inflationary monetary control covering a five year period. This policy should be publicly announced and explained in order to establish a credible commitment by the Federal Reserve Authorities. As a further component of a coherently developed monetary control the Fed must ultimately attend to lower the variance of the growth rate pursued over one year. A lower variance in the growth rate of the monetary base offers no serious technical problems. It only required appropriate procedures and the political will to execute the program.

IV. Major Obstructions to An Anti-Inflationary Policy

The drift into permanent inflation since 1965 and the series of failures in monetary policymaking directs our interest to the conditions producing this result. Two sets of conditions deserve our attention in this context: the Fed's procedures and mode of implementing policy and the prevailing conceptions concerning monetary policy and the nature of the inflation process.

1. The Role of Implementation Procedures and Institutional Structure

The Fed traditionally executes policies by setting a target range for the Federal Funds rate and adjusting open market operations in order to maintain the fund rate within the target band. The detail of the procedure has been described on

many occasions. It has also been demonstrated that this procedure yields a poor control over the movement of monetary aggregates including the monetary base. The Federal Reserve's commitment to this mode of implementing policy severely obstructs any effective attention to monetary growth or even the growth rate of the monetary base. A reliable anti-inflationary policy described in a previous paragraph requires a thorough restructuring of the Fed's procedures. The general nature of the required procedure has been described in several position papers over the past years. This procedure is based on an estimate of the desired target of monetary growth. This selection depends on the desired longer-range movements of the price-level and the economy's normal real growth. A second step formulates estimates of the time profile for the monetary multiplier. These two steps imply the required growth rate of the monetary base. Projections of the source components of the base other than Federal Reserve Credit determine ultimately the anticipated path of the Fed's net open market operations over various horizons ahead. The accrual of data from week to week and month to month offers opportunities for sequential shorter-run readjustments in the required volume of open market operations. We may note at this point that this procedure essentially corresponds to the arrangement developed over the past four years by the Swiss National Bank.

This mode of monetary controls requires of course a substantial investment by the Fed to obtain meaningful and reliable data on the domestic money stock. The work of the Bach Committee need be continued for this purpose. The study prepared by the staff and published last January in the Federal Reserve Bulletin forms just a beginning in the work on the data necessary for an adequate monetary control. It follows that for the moment, until this work has been seriously accomplished, the alternative to the Fed's traditional procedure remains quite simple. The "ultimate target" for the growth of the monetary base need be announced together with the stepwise reduction proceeding over the next three to five years. The Fed knows under the circumstances the average of the monetary base for each month in the forthcoming period. This information guides the ongoing adjustment of the open market account.

2. The Role of Various Conceptions

a. The Fed's Tradition

The model of implementing policy gradually evolved over the decades. It changed over time in some detail and the relative frequency of key words

occurring in policy statements may have shifted over time. But it always remained anchored on a view centrally addressed to interest rates and money market conditions. The underlying interpretation changed however during the 1960's. A Keynesian money market view replaced a free reserve doctrine originally derived from the Strong-Riefler-Burgess conception dominating the Fed's approach to the world in the 1920's and during the Great Depression. The change of interpretation moved the demand function for money and its alleged instability to the center of the Fed's attention. It did not modify however the Fed's orientation centered on interest rates. It just provided an up-dated basis with better opportunities at rationalizations. Monetary control remained a marginal concern basically alien to the Federal Reserve bureaucracy's tradition. The moderate pressure from Congress and outside groups for an effective policy of monetary control was essentially absorbed by astute gestures and rhetorical concessions. The story of the last four years under House concurrent Rule 133 and the revised Federal Reserve Act demonstrates that the demand for monetary control essentially encountered a hostile rejection by the Federal Reserve's bureaucracy. The rhetorical concessions were sufficient however to produce a useful confusion among the media and financial analysts. An impression was generated that "monetarism" was really tried and it failed to be feasible.

The entrenched views, customs and procedures of the Federal Reserve bureaucracy thus form a subtle but powerful barrier obstructing the development of an effective monetary control. The same views ultimately obstruct the determined application of a reliable and predictable anti-inflationary policy. The role of the established bureaucracy with its traditional posture and incentives also determines the expectations concerning the impact of the new Chairman of the Board. The intelligence, integrity and competence as a political administrator of the new Chairman is hardly to be doubted. But this is not sufficient by itself to bring about the necessary change in our policymaking. The basic thrust of our policies will be determined by the established bureaucracy's traditional views and procedures. No major incentives operate on the bureaucracy to change its accustomed ways. Changes in personalities filling the position as chairman may affect under the circumstances the style and the rhetoric but are unlikely to produce substantive and maintained changes in policy. Any Chairman wishing to bring the Federal Reserve on a new course recommended by the House Committee on Banking and Currency, the Joint Economic Banking or the Shadow Open Market Committee

must start with an overhaul of the Fed's top level personnel. A new group of people would offer the best chance for the necessary restructuring of policy. The likelihood of a successfully maintained anti-inflationary policy diminishes as the "old crowd" continues on its accustomed way.

b. The Oil Price Shock and the Gap Syndrome

It was argued in 1975 that the large gap between "potential output" and actual output justified a highly expansionary monetary policy. The large gap produced by the recession of 1974 would essentially prevent any relevant inflationary effect on even very large monetary expansion. Such expansion would be absorbed by an increase in output with little spillover, if any, to the price-level. Even an annual growth rate between 10% and 15% of the money stock would pose no relevant inflationary danger under the circumstances. The Shadow Policy Committee was naturally criticized for its lack of concern about the output gap and the need to remove it. But the SOMC emphasized at the time that the magnitude of the gap is irrelevant in terms of the inflationary consequences of monetary expansions. Sustained large monetary accelerations affect price movements irrespective of the gap. Substantial work accumulated over recent years in support of this view. The Federal Reserve Authorities did not follow the expansionary advice at the time and moved more closely along the SOMC's cautious recommendation. But this was simply the outcome of the Fed's traditional procedure in the context of comparatively stable and low short-term interest rates.

The onset of monetary acceleration beyond 1975 demonstrates the fallacy of the gap syndrome. In contrast to the "gappist" thesis inflation mounted and doubled over the subsequent years, inspite of the gap and inspite of an unemployment rate in excess of the so-called "non-inflationary" benchmark level. Short-run adjustments of monetary growth to the magnitude of the gap in the context of an economy with long inflation experience contribute little to the closure of gaps over time. They produce however higher average rates of inflation and more erratic inflation. The latter implies moreover a corresponding variability of the sequence of gaps experienced over time by the economy. The best contribution monetary policy can make to lower the variability of output relative to normal output is the committed adherence to a predictable and stable monetary control path credibly understood by the mass of price and wage setters.

The obstacle posed by the gap syndrome to an effective anti-inflationary monetary policy has been reenforced by a pervasive misinterpretation of the oil price shock. The prevailing view interprets every decline of actual output as a decline relative to normal output producing a corresponding gap to be appropriately closed by expansionary monetary and fiscal action. The oil price shock should caution us about the fallacy in this view. A large increase in the relative price of energy inputs into the production process of western countries lowers the normal output of these economies. The OPEC shock of October 1973 probably lowered the normal output of the US economy by about 5%. The decline of 8% in real GNP observed from peak to trough reflected thus to a major extent not a recession but an adjustment in normal output. Only the remaining portion of about 3% expresses the effect of a recession. The order of magnitude of the recession coincides thus with the patterns observed over the first fifteen years of the postwar period. The oil price shock reminds us that we cannot infer from output movements alone whether or not a recession occurred. We need additional information in order to judge whether output declined as a result of a fall in normal output or whether it dropped relative to normal output. If it expresses a fall in normal output no increase in budgets, deficits and no increase in money stock whatever its magnitude will raise output again. In the other case output will rebound to the normal level provided policy does not aggravate recession by unleashing additional erratic negative shocks.

The point made in the previous paragraph applies to our current state. A second, fortunately much smaller oil price shock, imposes new adjustments on our economy. The resulting lowering of normal output will appear as a retardation in observable real growth. An interpretation of this adjustment as a recession with the ensuing demand for expansionary policies would further endanger any hope for an anti-inflationary course in our monetary policymaking. It is important that our policymakers and the public understand this issue. The occurrence of important real shocks is certainly generally acknowledged and discussed in the profession. One also seems to recognize some mechanical effects of higher oil import prices on domestic prices. But many fail to understand that real shocks are really "real", they do modify an economy's normal output. We would indulge a singular inconsistency to grant a price effect to a negative real shock and (more or less implicitly) deny any consequences with respect to normal output.

c. Anti-Inflationary Illusions and Inflationary Realities

A prevalent view asserts that the "inflation of the seventies is a new and different phenomenon". It follows that it "cannot be diagnosed correctly with old theories or treated effectively with old prescriptions" (Arthur Okun, 1979). The "new phenomenon" requires a correspondingly new diversified approach. This would include "enough fiscal-monetary discipline to provide a safety margin against excess demand, a coordinated federal initiative to reduce private costs and constructive measures to obtain price-wage restraint."

The case for the assertain of a "new phenomenon" is based on the appearance of increasing intractability of the inflation process. This intractability is expressed by the lowered responsiveness of price movements to emerging output gaps as in 1970 or 1974. The "intractability of the new phenomenon" is however less an expression of reality than the result of faulty analysis. We repeat first our previous point that price movements are poorly associated with gaps. An output gap affects price movements at most indirectly via the agents anticipations concerning the policy responses generated by emerging output gaps. There is however still another aspect of crucial significance for our purposes. Price and wage setters proceed on the basis for the best information available about the dominant trend. There are good reasons why price and wage setters disregard what they perceive as transitory conditions or shocks and adjust their prices and wages to the more permanent underlying conditions. This behavior, rationally adjusted to an uncertain environment, implies that responsiveness of price movements to monetary decelerations declines with the length of inflationary experiences, the variability of monetary growth and the frequency of aborted anti-inflationary policies, or the frequency of an anti-inflationary rhetoric in the context of permanent inflationary policies. We need not search for sinister "technostructures" or deeper sociological meanings behind the apparent intractability of our inflation. This intractability was tractably produced by our policies in a world essentially responsive to credible and sustained anti-inflationary policies. The pattern of unreliable anti-inflationary policies in the context of a permanent inflationary policy produces the observed price-wage momentum and a price-wage spiral apparently disconnected from current market conditions.

The "diversified approach" thus results from a basic misinterpretation of the ongoing inflation process. The background of the approach yields however little information about the consequences. The discussions for the three strands constituting the approach may be organized with the aid of an ancient relation connecting monetary growth and changes in the price-level. We write

$$\Delta \log m + \Delta \log v = \Delta \log p + \Delta \log y$$

i.e. monetary growth $\Delta \log m$ and the relative change in velocity $\Delta \log v$ form the changes in aggregate nominal demand confronting the relative change in the price-level $\Delta \log p$, and the rate of real growth $\Delta \log y$.

The conception of inflation underlying the "diversified policy approach" centers on the nature of the process shaping $\Delta \log p$. It is contended that $\Delta \log p$ moves in the short and a very long intermediate run essentially independently of the changes in aggregate nominal demand. The momentum of the price-level is approximately predetermined. It follows therefore that a reduction of monetary growth exerts a vanishing effect, if any, on $\Delta \log p$ and is dominantly absorbed by a decline in real growth $\Delta \log y$. Thus emerges the first strand of the "diversified approach" requiring that $(\Delta \log m + \Delta \log v)$ not exceed the sum of inherited inflation and normal real growth. It also requires that the change in aggregate nominal demand be <u>at least</u> equal to the current change in the value of normal output. This strand should thus assure that monetary-fiscal policy is never used to produce a recession. The constraint that changes in aggregate nominal demand be always at least equal to changes in the value of output implies of course that financial policy can never be used to curb inflation. The two other strands of the "diversified approach" are assigned this task.

The second strand imposes on the Federal Government the obligation to lower costs in the private sector. Two sets of actions are noted in this context. One refers to actions lowering real costs and the other to reductions in taxes which essentially lower the wedge between gross market prices and net labor costs per unit of output. The first group of measures would raise productivity via more efficient use of our resources. There is little doubt at this stage that our regulatory policies contributed to lower the normal rate of real growth over the past ten years and thus lower future achievable levels of output. A reversal of this trend in our overextended regulatory apparatus and activities would certainly be important in terms of our long run welfare. But the effect on the rate of inflation

is unfortunately quite negligible. Even an increase of one percentage point in the normal rate of growth would be an outstanding success and over the years signally affect our welfare. But it lowers the inflation rate only one percentage point in a basic inflation running now at 10% p.a. the courageous exercise of a "goodwill theory" of government with the matching disregard of political reality thus promises at best a minor decline in the rate of inflation.

The reduction of the wedge involves a very different story. We disregard for our purposes the shorter-run adjustments induced by a reduction of the wedge. It is important to penetrate beyond the appearances of the immediate impact and examine the more persistent results. A reduction in the wedge produces a once and for all decline in price level relative to the level otherwise existing provided the supply of labor and the supply of output responds positively to the resulting increase in net real income. This result also requires that suppliers do not experience an increase in disincentives due to a shift in taxes from the wedge to actual or anticipated higher levels of income taxes. Operations centered on the wedge thus affect (possibly) the level of normal output and the price level associated with a given money stock but hardly modify the persistent rate of inflation maintained over time. This will remain governed by the movement of aggregate nominal demand.

The problem associated with the "wedge approach" to control inflation may be considered from a different angle. Let the price-level be partitioned into two multiplicative components

$$p = w(1 + \omega)$$

where w is the net labor cost, (= net remuneration received by labor per unit of output and ω is the total wedge as a fraction of net labor costs. We obtain thus approximately

$$\Delta \log m + \Delta \log v = \Delta \log w + \Delta\omega + \Delta \log ny$$

Two cases may be examined. In the first case a lower wedge raises via positive supply incentives the level of normal output, whereas in the second case normal output remains unaffected. If the decline of w raises normal output there emerges over a transition period a layer $\Delta \log ny$ matched by a negative Δw. The rate of price change ($= \Delta \log + \Delta w$) thus falls temporarily reflecting the adjustment to a lower price-level at any given money stock. But after the transition with $\Delta w = 0$ and $\Delta \log ny$ on its usual path inflation settles again at the "basic rate" determined by permanent stance of financial policies.

In the second case normal output is unaffected and there occurs under the circumstances no price-level effect. The reduction of w, i.e. Δw produces over a transition period a corresponding increase in $\Delta \log w$. The changes in net labor cost bulges as the wedge is lowered and price movements are not affected beyond some shortest run erratic movements. We conclude thus that in either case the "operation wedge" remains a useless exercise with respect to the more permanent inflationary momentum, however useful it may potentially be in terms of the social cost of government and the labor markets. Juggling the wedge thus satisfies at best the myopic attention in policymaking attuned to short-run results combined with systematic neglect of longer-range and persistent consequences. It creates the impression of an anti-inflationary policy as the price-level shifts to a comparatively lower level (permanently in the first case and shortly in the second) but without significant effect on the permanent rate of inflation produced by persistent financial policies.

The third strand offers an old story. Price controls have been tried since political institutions controlling money exploited their opportunities in order to extract resources. Controls usually failed and so have income policies of all grades. The proposal emanating from Brookings refrains from advocating mandatory controls but does advance a "non-mandatory" procedure involving threats and pressures. It is recognized that every program of income policy wears out, loses effectiveness on the market place and encounters a rapid decay in political support. A "large supply" of income policies is thus required allowing a rapid succession of an imaginative array of such programs. The consequences of this strand of a "diversified approach" enhance the uncertainty about the rules of the game confronting the private sector. Previous position papers emphasized the effect resulting from the trend in our policy and the expanded regulatory activism on the development of the stock market and the stagnation of private investment expenditures. The net effect of the extra-legal and extra-constitutional exercise in political manipulation of price-wage setting would be a further deterioration in the normal rate of real growth. The longer-run political implications of this approach may deserve careful attention beyond the narrow confines of this position paper.

One last point concerning controls (mandatory or non-mandatory) need be noted. Their reference point is the rate of inflation as an average of all price movements. But allocative real shocks continuously modify relative prices.

Controllers, as the media, are naturally disposed to indulge in a "reverse Lucas misinterpretation": relative price increases are typically misinterpreted as reflecting aggregate price movements. This propensity obstructs allocative efficiency and distorts the usage patterns of our resources.

The "diversified approach" to curb inflation seriously endangers our economic and political welfare. it fosters policies raising the likelihood of permanent, high and erratic inflation (strand one). It also obstructs our real growth and threatens over the longer horizon the political institution of a free society (strand three). Lastly, the second strand reinterpreted as a program to lower the social cost of government would usefully contribute to our well being. As it stands it is poorly conceived, dangerous to our longer-range welfare, and irrelevant as anti-inflationary policies.

Table 1: The Velocity of the Monetary Base

I	1947	6.0	I	1958	10.2	I	1969	13.6
II	1947	6.1	II	1958	10.2	II	1969	13.7
III	1947	6.2	III	1958	10.5	III	1969	13.8
IV	1947	6.4	IV	1958	10.7	IV	1969	13.7
I	1948	6.6	I	1959	10.9	I	1970	13.7
II	1948	6.9	II	1959	11.2	II	1970	13.7
III	1948	7.0	III	1959	11.0	III	1970	13.7
VI	1948	7.1	IV	1959	11.2	IV	1970	13.5
I	1949	7.0	I	1960	11.6	I	1971	13.7
II	1949	6.9	II	1960	11.5	II	1971	13.7
III	1949	7.0	III	1960	11.4	III	1971	13.6
IV	1949	7.0	IV	1960	11.4	IV	1971	13.7
I	1950	7.3	I	1961	11.3	I	1972	13.9
II	1950	7.5	II	1961	11.6	II	1972	14.0
III	1950	8.0	III	1961	11.7	III	1972	14.1
IV	1950	8.2	IV	1961	11.8	IV	1972	14.1
I	1951	8.5	I	1962	12.0	I	1973	14.3
II	1951	8.6	II	1962	12.1	II	1973	14.3
III	1951	8.7	III	1962	12.1	III	1973	14.4
IV	1951	8.7	IV	1962	12.1	IV	1973	14.5
I	1952	8.7	I	1963	12.1	I	1974	14.4
II	1952	8.6	II	1963	12.1	II	1974	14.4
III	1952	8.7	III	1963	12.2	III	1974	14.4
IV	1952	8.9	IV	1963	12.2	IV	1974	14.3
I	1953	9.0	I	1964	12.3	I	1975	14.1
II	1953	9.0	II	1964	12.4	II	1975	14.2
III	1953	8.9	III	1964	12.4	III	1975	14.6
IV	1953	8.8	IV	1964	12.3	IV	1975	14.6
I	1954	8.8	I	1965	12.5	I	1976	14.8
II	1954	8.8	II	1965	12.6	II	1976	14.8
III	1954	8.9	III	1965	12.7	III	1976	14.9
IV	1954	9.0	IV	1965	12.8	IV	1976	14.8
I	1955	9.3	I	1966	13.0	I	1977	15.0
II	1955	9.5	II	1966	13.0	II	1977	15.2
III	1955	9.7	III	1966	13.1	III	1977	15.2
IV	1955	9.8	IV	1966	13.2	IV	1977	15.2
I	1956	9.8	I	1967	13.1	I	1978	15.1
II	1956	9.9	II	1967	13.1	II	1978	15.5
III	1956	10.0	III	1967	13.1	III	1978	15.5
IV	1956	10.2	IV	1967	13.2	IV	1978	15.6
I	1957	10.3	I	1968	13.2	I	1979	16.0
II	1957	10.4	II	1968	13.4	II	1979	16.0
III	1957	10.5	III	1968	13.5			
IV	1957	10.4	IV	1968	13.5			

WEEKLY FEDERAL RESERVE REPORT

September 7, 1979

Credit markets are showing signs characteristic of the final stages of a cyclical upsurge in short-term interest rates. Commercial and industrial credits on the books of major New York City banks rose by $1-billion during the week ended September 5. Over the past three months such loans have been rising at a seasonally adjusted compound annual rate of 34%. It is typical that New York City banks should be the last to feel the pressure of intense credit demands at the tail end of an interest rate cycle. These institutions play a key role as lender of last resort to major firms that normally are slow to be affected by a squeeze on corporate liquidity. Thus, the usual cyclical pattern suggests that by the time truly intense demand pressures hit the New York banks, the rise in interest rates is almost over. Indeed, with the exception of a single, aberrational week in 1978, one has to go back to mid-June 1974 to find an increase in business loans in New York City as large as the one registered this week. Short-term interest rates peaked out in that cycle about six weeks later.

Viewed more broadly, the data indicate that the crest of credit demand in the current business cycle may already be passing. The Morgan Stanley proxy for total short-term business credit outstanding dropped by $302-million in the week ended August 29, the first weekly decline for this key measure of the credit markets in more than six months. More importantly, the short-run (four-week to four-week) rate of change in the Morgan Stanley proxy was 22.8% in the period ended on the 29th, down substantially from the 30% to 35% rates of increase that were posted only a month ago. On the assumption that our forecast of general economic activity is correct, and more pervasive weakness in business becomes apparent in the fourth quarter, we would expect to see additional declines in the rate of growth of short-term credit outstanding in the weeks ahead. Should demand for short-term credit begin to subside as we anticipate, we expect that the Federal Reserve System will acknowledge this development only reluctantly. The authorities will undoubtedly allow the official target for short-term interest rates to decline, but they will probably do so only hesitantly, well after the shift in demand forces in the marketplace. As a result, monetary policy - as measured by the rate of change in the monetary aggregates -- is more likely to tighten than ease as the economy slips into recession.

We should emphasize that this analysis looks ahead to the end of the fourth quarter and the first part of 1980. In the immediate future, the probabilities suggest continuing increases in short-term rates. Even with the jumps in the official target for Federal funds that the authorities have allowed in the last month, it is plain that rates have been too low, and that in order to slow the upward movement

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of money costs, the Federal Reserve has been forced to add large amounts of high-powered money to the marketplace. The monetary base, for example, averaged $150-billion in the four weeks ended on September 5, up at a 14.2% seasonally adjusted compound annual rate from the average of $148.4-billion in the four-week period ended August 8. Total effective reserves in the banking system averaged $45.8-billion in the four weeks ended August 29, up at a whopping 39.2% annual rate from the comparable average four weeks earlier. These growth rates are obviously far above levels that could be considered consistent with a noninflationary monetary policy.

Federal Reserve Data

(Weekly Averages of Daily Figures; in Millions of Dollars)

	Latest Week	Change From Prev. Week	Rates of Change Over 3 Months	6 Months	1 Year
Money Supply (M-1)*(1)	$374,700	$+ 600	+11.4%	+ 9.0%	+ 5.0%
M-1-Plus* (1)	598,900	+ 700	+10.5	+ 6.4	+ 2.6
Money Supply Plus Comm'l Bank Time Deposits Other Than Large CDs (M-2)* (1)	924,300	+1,700	+13.5	+10.7	+ 7.7
Adjusted Monetary Base* (2)	150,600	+ 300	+12.6	+ 9.0	+ 8.5
Adjusted Federal Reserve Credit* (2)	130,800	+ 400	+12.9	+ 8.5	+ 9.5
Total Effective Bank Reserves* (1)	46,100	+ 300	+10.7	+ 4.6	+ 4.1
Member Bank Borrowing (2)	1,340	+ 224	NA	NA	NA
Wednesday Figures					
Short-Term Business Credit* (1)	257,558	- 302	+28.4	+26.2	+22.0
Total Commercial Paper Outstanding* (1)	105,298	- 747	+45.3	+46.4	+38.7
Business Loans:					
All Large Banks* (1)	149,730	+ 246	+26.2	+23.4	+17.6
New York City Banks* ** (2)	42,911	+1,002	+34.0	+27.2	+20.6
Chicago Banks* (2)	15,386	+ 277	+ 7.1	+22.1	+24.0

*Seasonally Adjusted **Excludes bankers' acceptances and commercial paper

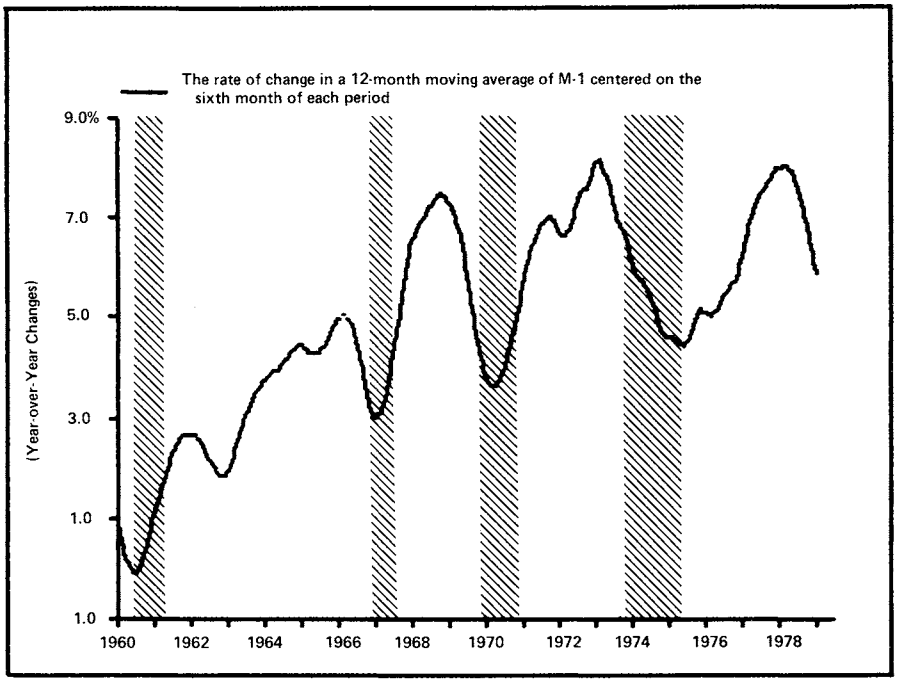
NA = Not Applicable N/AV = Not Available

Rates of change are compound annual rates. Short-term business credit includes commercial and industrial loans at large banks plus loans sold to affiliates less bankers' acceptances and commercial paper held in portfolio plus loans at large banks to finance companies and nonbank financial institutions plus nonbank commercial paper.

(1) August 29 (2) September 5

Figure 1

The Underlying Rate of Monetary Expansion -- M-1



Shaded areas represent periods of recession as designated by the National Bureau of Economic Research except for the mini-recession of 1966-1967.

Sources : Chase Econometric Associates Data Base; Morgan Stanley Research

If our reasoning is accurate, then this problem of excessive expansion in high-powered money will be corrected -- to the extent that such problems are ever "solved" -- as much by market forces as by official action. In other words, a combination of further increases in the official target for the Federal funds rate and some easing in the demand for short-term credit should bring money costs into equilibrium only moderately above present levels. Even on the assumption that short-term rates continue to rise, we see very little additional price risk in the long-term bond market, and we continue to believe that yields on long-term, high-grade corporate credits (for instance, the obligations of selected telephone subsidiaries) posted their highs for this business cycle in late April and early May. (At that time, quality telephone credits were selling to yield about 9.8%.)

THE ECONOMIC OUTLOOK

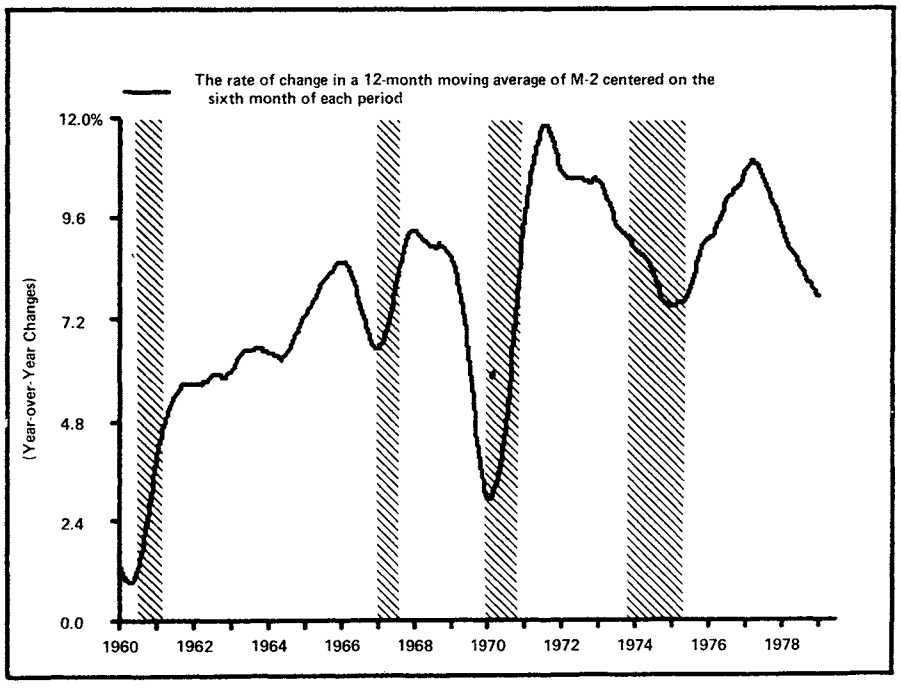
The basic question that business forecasters must face at present is whether the surge of money growth since the end of the first quarter this year has invalidated the program of monetary restraint that the Federal Reserve System began to implement in the summer and fall of 1978. Our answer to this question is "no." We believe very strongly that if monetary actions are to be meaningful to the general economy, they must be sustained for a substantial period. Short-run accelerations or decelerations in money growth may

-- and usually do -- affect inflationary expectations among market participants, but they rarely have a significant influence on the trend of change in real output. Furthermore, we have concluded that the measure we have dubbed the "underlying rate of monetary expansion" -- see Figure 1 on page 3 and Figure 2 below -- is the best indicator that we have been able to devise of sustained changes in the rate of monetary expansion. Both figures indicate clearly that the sustained slowdown in monetary growth that has been in place for the past year (two years in the case of M-2) has continued up until the present, despite the rapid increase in the aggregates since last winter. In statistical terms, this is a function of the fact that monetary growth at the end of 1978 and in early 1979 was exceptionally slow. We would be the first to argue that the surge of monetary expansion in the past five months has been damaging to inflationary expectations in the marketplace, and that it must be controlled. However, if the surge of money growth is in fact brought under control (though a combination, as we suggested, of official actions and changes in market factors), then we would conclude that the fundamental pattern of restraint is still in place.

Our analysis indicates the pervasive weakness of real spendable income at the consumer level has started to erode real final demand to the point where business firms are finding themselves compelled to bring their stocks of unsold goods into better alignment with realistic sales forecasts. This is showing up in the form of distinct weakness in key sectors in transportation, as well as in the marked uptick in the unemployment rate that was registered during August. On balance, we would conclude that with monetary restraint being pressed (albeit in a long-term sense), the income stream weakening,

Figure 2

The Underlying Rate of Monetary Expansion -- M-2



Shaded areas represent periods of recession as designated by the National Bureau of Economic Research except for the mini-recession of 1966-1967.

Sources: Chase Econometric Associates Data Base; Morgan Stanley Research

unemployment rising, and the consumer balance sheet badly distorted by excessive debt burdens, the probabilities are rising in favor of a pattern of sustained and cumulative economic weakness through the middle of next year. A moderate inventory cycle (reinforced at a later date by a downturn in capital goods) should help to trigger (and then extend) the decline, but the basic adjustments are likely to occur at the consumer level. In this environment of sustained weakness in product markets, the reported rate of change in prices should begin to show some marked improvement by mid-1980.

The interest rates regularly monitored by the Federal Reserve were as follows:

Rate	Daily Average Week Ended August 29	Daily Average Week Ended September 5	Change in Basis Points
Federal Funds	11.16%	11.02%	-14
90-Day Treasury Bills	9.67	9.91	+24
90- to 119-Day Commercial Paper	10.76	11.03	+27
90-Day CDs (Secondary Market)	11.08	11.36	+28
90-Day Eurodollars	12.10	12.19	+ 9
20-Year Governments	9.01	9.13	+12

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September 7, 1979

STATISTICAL APPENDIX -- CAPITAL MARKET ACTIVITY

Table 1

Bond Market Volume 1971-1979*

Publicly Offered Nonconvertible Debt
($ Millions)

	1971	1972	1973	1974	1975	1976	1977	1978	1979
January	$ 1,960	$ 2,483	$ 1,130	$ 2,521	$ 3,680	$ 2,670	$ 2,964	$ 1,370	$ 1,891
February	2,115	1,846	602	2,071	3,759	2,323	1,371	1,212	1,862
March	3,924	1,891	1,662	2,300	3,684	3,267	2,652	2,740	1,731
Total 1st Quarter	$ 7,999	$ 6,220	$ 3,394	$ 6,892	$11,123	$ 8,260	$ 6,987	$ 5,322	$ 5,484
April	$ 1,797	$ 1,876	$ 1,558	$ 2,149	$ 2,866	$ 2,713	$ 2,263	$ 2,591	$ 3,078
May	1,968	1,563	910	2,288	3,844	2,425	1,496	2,328	2,057
June	1,814	1,316	1,502	1,917	4,150	3,610	2,890	1,867	3,776
Total 2nd Quarter	$ 5,579	$ 4,755	$ 3,970	$ 6,354	$10,860	$ 8,748	$ 6,649	$ 6,786	$ 8,911
July	$ 1,547	$ 1,759	$ 1,200	$ 2,065	$ 3,112	$ 1,681	$ 3,053	$ 2,067	$ 2,028
August	1,458	1,420	937	2,018	1,287	1,746	1,825	1,471	2,005
September	2,154	1,296	671	1,025	1,569	2,264	2,104	1,574	
Total 3rd Quarter	$ 5,159	$ 4,475	$ 2,808	$ 5,108	$ 5,968	$ 5,691	$ 6,982	$ 5,112	
October	$ 1,980	$ 1,940	$ 1,699	$ 3,565	$ 2,345	$ 2,857	$ 2,376	$ 2,363	
November	1,882	1,951	1,935	3,111	2,292	2,423	2,478	1,712	
December	1,423	1,390	2,118	2,701	2,537	2,687	1,712	1,094	
Total 4th Quarter	$ 5,285	$ 5,281	$ 5,752	$ 9,377	$ 7,174	$ 7,967	$ 6,566	$ 5,169	
Total	$24,022	$20,731	$15,924	$27,731	$35,125	$30,666	$27,184	$22,389	

*Excludes Federal, state, and local issues as well as tax-exempt pollution control financings; includes a limited number of underwritten offers by Federal agencies

Source: Morgan Stanley & Co. Incorporated

Table 2

Public Bond Sales; 1978 and Year-to-Date 1979
By Type of Issuer
($ Millions)

	Banks & Fin.	For. & Provinc.	Indus-trials	Tele-phone	Trans-port.	Utility	Misc.	Total
1978								
January	$ 150	$ 500	$ 75	$ 300	$ 30	$ 315	--	$ 1,370
February	650	--	337	--	60	165	--	1,212
March	675	950	200	275	232	388	$ 20	2,740
Total 1st Quarter	$ 1,475	$ 1,450	$ 612	$ 575	$ 322	$ 868	$ 20	$ 5,322
Percent	27.7%	27.2%	11.5%	10.8%	6.1%	16.3%	0.4%	100.0%
April	$ 1,071	$ 550	$ 431	$ 35	$ 174	$ 330	--	$ 2,591
May	530	650	437	--	196	500	$ 15	2,328
June	351	270	258	250	148	540	50	1,867
Total 2nd Quarter	$ 1,952	$ 1,470	$ 1,126	$ 285	$ 518	$ 1,370	$ 65	$ 6,786
Percent	28.8%	21.7%	16.7%	4.2%	7.6%	20.2%	1.0%	100.0%
July	$ 785	$ 100	$ 258	$ 360	$ 39	$ 525	--	$ 2,067
August	150	125	353	450	18	375	--	1,471
September	35	325	569	185	55	405	--	1,574
Total 3rd Quarter	$ 970	$ 550	$ 1,180	$ 995	$ 112	$ 1,305	--	$ 5,112
Percent	19.0%	10.8%	23.1%	19.5%	2.2%	25.5%	--	100.0%
October	$ 363	$ 750	$ 180	$ 275	--	$ 775	$ 20	$ 2,363
November	500	250	400	400	$ 42	120	--	1,712
December	350	--	359	150	15	120	100	1,094
Total 4th Quarter	$ 1,213	$ 1,000	$ 939	$ 825	$ 57	$ 1,015	$ 120	$ 5,169
Percent	23.5%	19.3%	18.2%	16.0%	1.1%	19.6%	2.3%	100.0%
Total 1978	$ 5,610	$ 4,470	$ 3,857	$ 2,680	$ 1,009	$ 4,558	$ 205	$22,389
Percent	25.1%	20.0%	17.2%	12.0%	4.5%	20.3%	0.9%	100.0%
1979								
January	$ 500	$ 575	$ 325	$ 150	$ 21	$ 220	$ 100	$ 1,891
February	225	610	58	550	44	375	--	1,862
March	585	--	371	450	85	140	100	1,731
Total 1st Quarter	$ 1,310	$ 1,185	$ 754	$ 1,150	$ 150	$ 735	$ 200	$ 5,484
Percent	23.9%	21.6%	13.7%	21.0%	2.7%	13.4%	3.6%	100.0%
April	$ 1,495	$ 200	$ 443	$ 200	$ 59	$ 675	$ 6	$ 3,078
May	625	300	564	75	48	445	--	2,057
June	1,125	300	1,113	350	213	675	--	3,776
Total 2nd Quarter	$ 3,245	$ 800	$ 2,120	$ 625	$ 320	$ 1,795	$ 6	$ 8,911
Percent	36.4%	9.0%	23.8%	7.0%	3.6%	20.1%	0.1%	100.0%
July	$ 890	$ 275	$ 698	--	$ 45	$ 120	--	$ 2,028
August	681	100	562	$ 300	122	140	$ 100	2,005
Total Year-to-Date	$ 6,126	$ 2,360	$ 4,134	$ 2,075	$ 637	$ 2,790	$ 306	$18,428
Percent	33.2%	12.8%	22.4%	11.3%	3.5%	15.1%	1.7%	100.0%

Source: Morgan Stanley & Co. Incorporated

Table 3

Public Bond Sales; 1978 and Year-to-Date 1979
By Rating of Issuer
($ Millions)

	Moody's Rating				Unrated	
	Aaa	Aa	A	Baa	or Lower	Total
1978						
January	$ 300	$ 620	$ 200	$ 225	$ 25	$ 1,370
February	319	566	140	150	37	1,212
March	1,299	203	702	288	248	2,740
Total 1st Quarter	$ 1,918	$ 1,389	$ 1,042	$ 663	$ 310	$ 5,322
Percent	36.0%	26.1%	19.6%	12.5%	5.8%	100.0%
April	$ 745	$ 597	$ 470	$ 25	$ 754	$ 2,591
May	675	671	407	220	355	2,328
June	426	552	495	90	304	1,867
Total 2nd Quarter	$ 1,846	$ 1,820	$ 1,372	$ 335	$ 1,413	$ 6,786
Percent	27.2%	26.8%	20.2%	4.9%	20.8%	100.0%
July	$ 460	$ 664	$ 585	$ 200	$ 158	$ 2,067
August	693	400	175	--	203	1,471
September	375	445	419	--	335	1,574
Total 3rd Quarter	$ 1,528	$ 1,509	$ 1,179	$ 200	$ 696	$ 5,112
Percent	29.9%	29.5%	23.1%	3.9%	13.6%	100.0%
October	$ 1,275	$ 375	$ 225	$ 235	$ 253	$ 2,363
November	650	692	230	100	40	1,712
December	400	210	285	75	124	1,094
Total 4th Quarter	$ 2,325	$ 1,277	$ 740	$ 410	$ 417	$ 5,169
Percent	45.0%	24.7%	14.3%	7.9%	8.1%	100.0%
Total 1978	$ 7,617	$ 5,995	$ 4,333	$ 1,608	$ 2,836	$22,389
Percent	34.0%	26.8%	19.4%	7.2%	12.7%	100.0%
1979						
January	$ 1,071	$ 530	$ 125	$ 140	$ 25	$ 1,891
February	1,059	170	475	100	58	1,862
March	791	559	340	--	41	1,731
Total 1st Quarter	$ 2,921	$ 1,259	$ 940	$ 240	$ 124	$ 5,484
Percent	53.3%	23.0%	17.1%	4.4%	2.3%	100.0%
April	$ 1,461	$$ 488	$ 610	$ 285	$ 234	$ 3,078
May	799	275	599	245	139	2,057
June	900	1,122	1,310	50	394	3,776
Total 2nd Quarter	$ 3,160	$ 1,885	$ 2,519	$ 580	$ 767	$ 8,911
Percent	35.5%	21.2%	28.3%	6.5%	8.6%	100.0%
July	$ 925	$ 640	$ 225	$ 100	$ 138	$ 2,028
August	720	675	305	--	305	2,005
Total Year-to-Date	$ 7,726	$ 4,459	$ 3,989	$ 920	$ 1,334	$18,428
Percent	41.9%	24.2%	21.6%	5.0%	7.2%	100.0%

Source: Morgan Stanley & Co. Incorporated

Table 4

Public Bond Sales; 1978 and Year-to-Date 1979
By Maturity
($ Millions)

	Five to Ten Years	Over Ten Years	Total
1978			
January	$ 175	$ 1,195	$ 1,370
February	350	862	1,212
March	900	1,840	2,740
Total 1st Quarter	$ 1,425	$ 3,897	$ 5,322
Percent	26.8%	73.2%	100.0%
April	$ 1,070	$ 1,521	$ 2,591
May	450	1,878	2,328
June	487	1,380	1,867
Total 2nd Quarter	$ 2,007	$ 4,779	$ 6,786
Percent	29.6%	70.4%	100.0%
July	$ 560	$ 1,507	$ 2,067
August	175	1,296	1,471
September	406	1,168	1,574
Total 3rd Quarter	$ 1,141	$ 3,971	$ 5,112
Percent	22.3%	77.7%	100.0%
October	$ 550	$ 1,813	$ 2,363
November	450	1,262	1,712
December	475	619	1,094
Total 4th Quarter	$ 1,475	$ 3,694	$ 5,169
Percent	28.5%	71.5%	100.0%
Total 1978	$ 6,048	$16,341	$22,389
Percent	27.0%	73.0%	100.0%
1979			
January	$ 480	$ 1,411	$ 1,891
February	300	1,562	1,862
March	400	1,331	1,731
Total 1st Quarter	$ 1,180	$ 4,304	$ 5,484
Percent	21.5%	78.5%	100.0%
April	$ 868	$ 2,210	$ 3,078
May	845	1,212	2,057
June	1,630	2,146	3,776
Total 2nd Quarter	$ 3,343	$ 5,568	$ 8,911
Percent	37.5%	62.5%	100.0%
July	$ 575	$ 1,453	$ 2,028
August	504	1,501	2,005
Total Year-to-Date	$ 5,602	$12,826	$18,428
Percent	30.4%	69.6%	100.0%

Source: Morgan Stanley & Co. Incorporated

Table 5

Publicly Offered Convertible Debt;
1978 and Year-to-Date 1979
($ Millions)

	Industrials	Banks & Ins.	Transportation	Misc.	Total
1978					
Total 1st Quarter	--	--	--	--	--
April	$ 12	--	--	--	$ 12
May	--	--	--	--	--
June	70	$ 50	--	--	120
Total 2nd Quarter	$ 82	$ 50	--	--	$ 132
Percent	62.1%	37.9%	--	--	100.0%
July	--	--	--	--	--
August	--	--	--	--	--
September	$ 85	--			$ 85
Total 3rd Quarter	$ 85	--	--	--	$ 85
Percent	100.0%	--	--	--	100.0%
October	$ 100	--	--	--	$ 100
November	12	$ 4	--	$ 10	26
December	6	--		--	6
Total 4th Quarter	$ 118	$ 4	--	$ 10	$ 132
Percent	89.4%	3.0%	--	7.6%	100.0%
Total 1978	$ 285	$ 54	--	$ 10	$ 349
Percent	81.7%	15.5%	--	2.9%	100.0%
1979					
January	--	--	--	--	--
February	--	--	--	--	--
March	--	--	--	--	--
Total 1st Quarter	--	--	--	--	--
April	--	--	--	--	--
May	--	--	--	--	--
June	$ 35	--	$ 150	--	$ 185
Total 2nd Quarter	$ 35	--	$ 150	--	$ 185
Percent	18.9%	--	81.1%	--	100.0%
July	--	$ 116	$ 30	--	$ 146
August	$ 15	10	--	$ 130	155
Total Year-to-Date	$ 50	$ 126	$ 180	$ 130	$ 486
Percent	10.3%	25.9%	37.0%	26.7%	100.0%

Source: Morgan Stanley & Co. Incorporated

Table 6

Underwritten Public Common Stock Sales; 1978 and Year-to-Date 1979
By Type of Issuer and Issue
($ Millions)

	Banks & Fin.	Indus-trials	Tele-phone	Utility	Trans.	Secondary Offers	Misc.	Total
1978								
January	--	--	--	$ 349	--	$ 71	$ 3	$ 423
February	--	--	--	147	--	--	--	147
March	$ 14	$ 28	--	521	--	1	--	564
Total 1st Quarter	$ 14	$ 28	--	$ 1,017	--	$ 72	$ 3	$ 1,134
Percent	1.2%	2.5%	--	89.7%	--	6.3%	0.3%	100.0%
April	--	$ 12	--	$ 60	$ 19	$ 39	$ 8	$ 138
May	$ 40	34	--	420	--	6	--	500
June	173	158	5	234	--	59	--	629
Total 2nd Quarter	$ 213	$ 204	$ 5	$ 714	$ 19	$ 104	$ 8	$ 1,267
Percent	16.8%	16.1%	0.4%	56.4%	1.5%	8.2%	0.6%	100.0%
July	$ 42	$ 268	$ 24	$ 28	--	$ 52	--	$ 414
August	8	139	7	217	--	144	--	515
September	83	156	--	343	--	70	--	652
Total 3rd Quarter	$ 133	$ 563	$ 31	$ 588	--	$ 266	--	$ 1,581
Percent	8.4%	35.6%	2.0%	37.2%	--	16.8%	--	100.0%
October	$ 19	$ 177	--	$ 583	--	$ 167	--	$ 946
November	--	3	--	394	$ 3	12	$ 2	414
December	5	57	--	143	--	10	--	215
Total 4th Quarter	$ 24	$ 237	--	$ 1,120	$ 3	$ 189	$ 2	$ 1,575
Percent	1.5%	15.0%	--	71.1%	0.2%	12.0%	0.1%	100.0%
Total 1978	$ 384	$ 1,032	$ 36	$ 3,439	$ 22	$ 631	$ 13	$ 5,557
Percent	6.9%	18.6%	0.6%	61.9%	0.4%	11.4%	0.2%	100.0%
1979								
January	$ 4	$ 42	--	$ 335	--	$ 13	$ 4	$ 398
February	--	102	--	434	--	10	--	546
March	--	26	--	147	$ 33	75	--	281
Total 1st Quarter	$ 4	$ 170	--	$ 916	$ 33	$ 98	$ 4	$ 1,225
Percent	0.3%	13.9%	--	74.8%	2.7%	8.0%	0.3%	100.0%
April	--	$ 67	--	$ 222	--	$ 15	$ 5	$ 309
May	$ 8	84	--	123	$ 20	22	--	257
June	--	90	--	172	15	24	--	301
Total 2nd Quarter	$ 8	$ 241	--	$ 517	$ 35	$ 61	$ 5	$ 867
Percent	0.9%	27.8%	--	59.6%	4.0%	7.0%	0.6%	100.0%
July	--	$ 83	$ 33	$ 267	--	$ 24	$ 4	$ 411
August	$ 6	157	--	331	--	32	--	526
Total Year-to-Date	$ 18	$ 651	$ 33	$ 2,031	$ 68	$ 215	$ 13	$ 3,029
Percent	0.6%	21.5%	1.1%	67.1%	2.2%	7.1%	0.4%	100.0%

Source: Morgan Stanley & Co. Incorporated

Table 7

Public Preferred Stock Sales; 1978 and Year-to-Date 1979
By Type of Issuer
($ Millions)

	Utility	Trans. & Industrials	Telephone	Ins. & Banks	Total
1978					
January	$ 116	--	--	--	$ 116
February	127	--	--	--	127
March	102	--	--	--	102
Total 1st Quarter	$ 345	--	--	--	$ 345
Percent	100.0%	--	--	--	100.0%
April	$ 110	$ 75	--	--	$ 185
May	177	35	--	$ 10	222
June	105	325*	--	57*	487
Total 2nd Quarter	$ 392	$ 435	--	$ 67	$ 894
Percent	43.8%	48.7%	--	7.5%	100.0%
July	--	$ 40*	--	$ 12*	$ 52
August	$ 91	--	--	20*	111
September	45	53*	--	--	$ 98
Total 3rd Quarter	$ 136	$ 93	--	$ 32	$ 261
Percent	52.1%	35.6%	--	12.3%	100.0%
October	--	--	--	--	--
November	$ 20	$ 7	--	$ 10	$ 37
December	148*	28*	--	--	176
Total 4th Quarter	$ 168	$ 35	--	$ 10	$ 213
Percent	78.9%	16.4%	--	4.7%	100.0%
Total 1978	$ 1,041	$ 563	--	$ 109	$ 1,713
Percent	60.8%	32.9%	--	6.4%	100.0%
1979					
January	$ 121	--	--	--	$ 121
February	226	--	--	--	226
March	--	--	--	--	--
Total 1st Quarter	$ 347	--	--	--	$ 347
Percent	100.0%	--	--	--	100.0%
April	$ 65	$ 38	--	--	$ 103
May	70	9*	--	--	79
June	91	--	--	$ 25*	116
Total 2nd Quarter	$ 226	$ 47	--	$ 25	$ 298
Percent	75.8%	15.8%	--	8.4%	100.0%
July	$ 170	$ 30	--	--	$ 200
August	110	184	--	$ 6	300
Total Year-to-Date	$ 853	$ 261	--	$ 31	$ 1,145
Percent	74.5%	22.8%	--	2.7%	100.0%

*Includes convertible preferred stock

Source: Morgan Stanley & Co. Incorporated

Table 8

Private Placements by Type of Issuer*; 1978 and Year-to-Date 1979
($ Millions)

	Banks	Foreign	Industrial	Telephone	Trans-portation	Utility	Misc.	Total
1978								
January	$ 42	--	$ 657	$ 10	$ 17	$ 35	--	$ 761
February	153	--	402	25	35	50	$ 10	675
March	101	$ 70	794	--	228	94	6	1,293
Total 1st Quarter	$ 296	$ 70	$ 1,853	$ 35	$ 280	$ 179	$ 16	$ 2,729
Percent	10.8%	2.6%	67.9%	1.3%	10.3%	6.6%	0.6%	100.0%
April	$ 35	$ 120	$ 513	$ 18	$ 38	$ 177	--	$ 901
May	175	30	840	150	121	569	--	1,885
June	109	60	333	100	258	935	--	1,795
Total 2nd Quarter	$ 319	$ 210	$ 1,686	$ 268	$ 417	$ 1,681	--	$ 4,581
Percent	7.0%	4.6%	36.8%	5.9%	9.1%	36.7%	--	100.0%
July	$ 92	$ 255	$ 1,320	$ 15	$ 44	$ 69	$ 115	$ 1,910
August	108	125	544	19	38	344	--	1,178
September	120	60	417	--	172	36	--	805
Total 3rd Quarter	$ 320	$ 440	$ 2,281	$ 34	$ 254	$ 449	$ 115	$ 3,893
Percent	8.2%	11.3%	58.6%	0.9%	6.5%	11.5%	3.0%	100.0%
October	$ 99	$ 27	$ 534	$ 30	$ 147	$ 286	--	$ 1,123
November	32	35	209	--	6	65	--	347
December	153	86	961	245	143	388	--	1,976
Total 4th Quarter	$ 284	$ 148	$ 1,704	$ 275	$ 296	$ 739	--	$ 3,446
Percent	8.2%	4.3%	49.4%	8.0%	8.6%	21.4%	--	100.0%
Total 1978	$ 1,219	$ 868	$ 7,524	$ 612	$ 1,247	$ 3,048	$ 131	$14,649
Percent	8.3%	5.9%	51.4%	4.2%	8.5%	20.8%	0.9%	100.0%
1979								
January	$ 78	$ 180	$ 758	$ 5	$ 86	$ 95	--	$ 1,202
February	74	6	636	2	78	150	--	946
March	53	39	432	--	256	131	$ 20	913
Total 1st Quarter	$ 205	$ 225	$ 1,826	$ 7	$ 420	$ 376	$ 20	$ 3,079
Percent	6.7%	7.3%	59.3%	0.2%	13.6%	12.2%	0.6%	100.0%
April	$ 312	$ 9	$ 794	$ 37	$ 311	$ 1,110	--	$ 2,573
May	139	49	332	67	289	137	$ 4	1,017
June	198	--	1,202	--	149	158	90	1,797
Total 2nd Quarter	$ 649	$ 58	$ 2,328	$ 104	$ 749	$ 1,405	$ 94	$ 5,387
Percent	12.0%	1.1%	43.2%	1.9%	13.9%	26.1%	1.7%	100.0%
July	$ 81	$ 123	$ 323	$ 33	$ 192	$ 290	$ 6	$ 1,048
August	57	--	360	52	150	109	20	748
Total Year-to-Date	$ 992	$ 406	$ 4,837	$ 196	$ 1,511	$ 2,180	$ 140	$10,262
Percent	9.7%	4.0%	47.1%	1.9%	14.7%	21.2%	1.4%	100.0%

*Data prior to 1979 includes publicly announced private placements done on an agency basis only.

Source: Morgan Stanley & Co. Incorporated

A Report on Fiscal Policy for the Shadow Open Market Committee

Rudolph G. Penner
American Enterprise Institute

Requiem for 1979

Fiscal 1979 will come to an end in two weeks. The perils involved in making deficit forecasts are well known, but it may be worthwhile to review the Administration's own 1979 deficit recommendations over time to provide a concrete example of the sensitivity of the deficit to policy changes and economic events.

TABLE 1

Administration Estimates of the 1979 Budget Totals
At Various Times Through 1978 and 1979
(Billions of dollars)

	Outlays	Receipts	Deficit
Original 1979 Budget, January 1978	500	440	-61
Mid-Session Review, July 1978	497	448	-49
1980 Budget, January 1979	493	456	-37
Mid-Session Review, July 1979	496	467	-30
August 1979	497	467	-30

Less than one-half of the $31 billion fall in the estimated deficit over time was the result of changes in policy, the most important of which was a one-quarter postponement and a reduction of the tax cut requested by the President in his original 1979 budget. The rest of the reduction was the result of errors in economic forecasting and errors in predicting

spending and receipts levels for a given set of economic conditions.

The 1980 Budget

While estimates of the 1979 deficit were steadily lowered since the budget was first submitted in January 1978, estimates of the 1980 deficit are very likely to move in the opposite direction over time. The latest Administration estimates were provided at the end of August in correspondence with the Senate Budget Committee. They are as follows:

TABLE 2

Outlays	$543.1 B.
Receipts	513.9 B.
Budget deficit	$ 29.1 B.
Off budget deficit	$ 11.6 B.
Total deficit	$ 40.7

Note that the estimate of the off-budget deficit has been lowered by $4.5 B. since the Mid-Session Review of July 12, 1979.

These estimates are based on the following economic forecast.

TABLE 3

Administration's Short-Run Economic Forecast

(Calendar Years)

	1979	1980
GNP (1972 dollars) percent change 4th quarter over 4th quarter	-0.5	2.0
CPI (percent change, December over December)	10.6	8.3
Unemployment rate (percent, 4th quarter)	6.6	6.9

The Administration's official forecast published in July, is more optimistic than most private forecasts (and also more optimistic than their own recent internal staff forecasts that have been leaked to the press), but there are many private forecasts that would not greatly alter the Administration's deficit forecast, given the President's current policy recommendations. For example, DRI's forecast is given below:

TABLE 4

DRI's Economic Forecast (July 24, 1979)

(Calendar Years)

	1979	1980
GNP (1972 dollars), percent change, 4th quarter over 4th quarter	-1.1	2.7
CPI (percent change, December over December)	11.3	8.5
Unemployment rate (percent, 4th quarter)	6.4	7.1

On the receipts side, the slightly deeper recession is offset by slightly higher inflation and receipts would fall only marginally. On the outlay side, higher inflation would raise outlays by less than $2 billion.*

The DRI forecast is used here as being typical of the "mild recession" forecast where that recession is assumed to have started already and a recovery is expected in early 1980. Many other forecasters assume that the real recession has not yet begun and that real GNP will grow in the third and perhaps in the fourth quarter abstracting from the effects of

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*The DRI forecast assumes a small discretianary increase in outlays. My $2 billion estimate refers only to endogenous spending changes.

a possible auto strike. A "real" recession is then expected for the first half of 1980.

This scenario poses significant difficulties for any budget forecast. Total receipts in fiscal 1980 will be extremely sensitive to the exact timing of the gyrations in GNP and their amplitude during the rest of 1979 and in early 1980. These gyrations will, in turn, be very sensitive to the length of the probable auto strike at the end of the third quarter. It is also a scenario that is conducive to a higher inflation rate throughout 1979 and early 1980 and this could have a significant positive effect on receipts.

For example, if real GNP is assumed flat for the rest of 1979; the auto strike is short enough to have a minimal effect on the macro aggregates; inflation is assumed to continue at a 10 percent rate through the end of 1980; and there is a fairly mild recession in the first half of calendar 1980; the unified deficit could actually be lower than in the Administration forecast by something less than $5 billion. Specifically, the economic forecast which goes with this deficit is as follows:

TABLE 5

Alternative Economic Forecast

(Calendar Years)

	1979	1980
GNP (1972 dollars), percent change, 4th quarter over 4th quarter	-0.2	+1.1
CPI (percent change, December over December)	11.0	10.0
Unemployment (percent, 4th quarter)	6.3	7.4

However, a slightly longer auto strike combined with a slightly deeper recession and lower inflation rate could cause the 1980 unified deficit to soar. Roughly speaking, a change in money GNP of one percent, extending through the fiscal year, changes receipts $6 to 7 billion dollars, although the impact can be far outside of this range depending on the distribution among different types of income, such as corporate profits, labor compensation, etc. A one percent downward adjustment in the CPI beginning in the first quarter of calendar 1980 would lower outlays on indexed programs by about $0.3 billion in fiscal 1980, and if short interest rates were reduced by the same amount, roughly another billion would be saved on net interest payments. A one percentage point increase in the average unemployment rate would cost about $3 billion. Therefore, downward deviations in either real growth or inflation, that are minor relative to typical forecasting errors, could easily cause the deficit to soar to the $40-50 billion range.

All of the above assumes Presidential tax and spending policies.* These policies are almost certain to change with or without the acquiescence of the President as unemployment begins to rise.

However, it would be dangerous to assume that there will be the same scramble to implement "stimulative" spending policies that we observed in 1975 and 1977. There is definitely a new mood in the Congress. For

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*At the moment there are some ambiguities in these policies. For example, it is not clear whether the "extra" pay raise recently announced by the President will have to be absorbed by agencies out of existing budgets or whether a supplemental will be requested. The above assumes that the extra $1.1 billion will be covered out of existing budgets. In addition, ongoing bargaining over the windfall profits tax could have a small effect on 1980 receipts.

the first time, the Senate Budget Committee is using the power provided in the Budget Act to direct Senate committees to take a second look at the spending legislation which has already been approved for 1980. This action is taken because those committees did not implement savings recommended in the First Budget Resolution. Further, the August Report on the second Budget Resolution is filled with rhetoric that gladdens the hearts of fiscal conservatives. For example: "inflation is the nation's most serious problem;" "We must not jump ship at the first sight of a storm;" "fiscal stimulus might come too late to rescue the economy from what many still predict will be a moderate and relatively brief recession."

Unfortunately, this rhetoric is mixed in with statements favorable to "targeted" stimulus programs, and the Report was published while unemployment was still constant. I do not expect the conservative sentiments of the Senate Budget Committee to prevail as the process evolves through the year, but it is important to note that the majority of the Committee is doing and saying things that have not been experienced in recent years. I, therefore, expect spending increases to be quite modest and will be surprised if discretionary increases exceed $5 billion if unemployment does not go beyond 8.0 percent.

Much of the conservative rhetoric is stimulated by concern over the size of the deficit. Even many liberals who favor a large government sector are, nevertheless, concerned that we are not moving faster toward a balanced budget. These sentiments create a formidable barrier against tax cuts as well as spending increases, but I would still forecast a sig-

nificant tax cut in 1980. Concern over the deficit may delay the enactment of the tax cut until early next year, but it is my guess that, in that case, it will be made retroactive to January 1, 1980.

I believe that concern over the deficit will be overridden by the by the fact that arguments for a tax cut can be based on a variety of very different economic theories and political motives.

1. Obvious politics - 1980 is an election year. It is also a year in which personal income tax increases caused by inflation, scheduled social security tax increases, and possible energy taxes will push the ratio of Federal receipts to GNP to unprecedented peacetime levels. Indeed, without a tax cut, we could even exceed the levels reached in the era of the Vietnam surtax. I cannot believe that this will be allowed to happen.

2. Subtle politics - Those concerned about rising tax burdens in the short run will be joined by those who believe that, in the long run, tax cuts provide the most effective method of cutting spending growth.

3. Keynesian economics - The built-in tax increases combined with virtually no real growth in Federal spending in 1979 and 1980 is causing a dramatic shift to fiscal restraint. According to CBO estimates, the full employment surplus will rise $54 billion over the two year period fiscal 1979 and 1980. With sluggish real growth and rising unemployment, many economists will testify in favor of reducing this increase.

4. Supply-side economics - Inflation is causing a rapid increase in marginal tax rates. For most of the population, those rates are now higher than they were before the Kennedy-Johnson tax cut. The most serious problem involves the tax rates imposed on the real return

to business investment. Feldstein and Summers estimate that inflation in 1977 raised the effective tax rate on the real return in the non-financial corporate sector from 43 to 66 percent. Between 1976 and 1977, the inflation rate was less than 7 percent. Thus, the "inflation tax" on capital is likely to be much higher this year and next.

The shape of the 1980 tax cut and its effect on the fiscal 1980 deficit will depend crucially on when it is passed. After January 1, it becomes virtually impossible to change 1980 social security taxes. Further, there is almost a two month time lag between enacting a personal tax reduction and changing withholding.

My own guess is that the Congress will act too late to change social security taxes in 1980 and that the tax cut will be heavily weighted toward easing the burden on investment by adopting very generous depreciation laws similar to those provided in Jones-Conable. However, I also expect some cuts in personal taxes. A total business and personal cut of $20 to $30 billion in 1980 liabilities seems likely, although it must be re-emphasized that there will be considerable concern over the effect on the deficit. I suspect the cut will be delayed sufficiently to keep the impact on the 1980 deficit to less than $10 billion.

It is not easy to summarize the above analysis as it piles uncertainty on uncertainty. To give the Committee something to criticize, I shall, therefore, attempt a "best guess."

My own favorite economic scenario involves somewhat less real growth and inflation than assumed in the economic assumptions of Table 5. With

current Presidental policy I would guess that the unified budget deficit would be around $40 billion. To that, I would add a $5 billion discretionary increase in appropriations, only $2 billion of which will be spent in fiscal 1980. Adding a $8 billion tax cut yields a unified budget deficit of $50 billion. The off-budget deficit will be about $12 billion for a total financing requirement of $62 billion.

Appendix A

Outlays of Off-Budget Federal Entities, Fiscal 1978
(in billions of dollars)

Federal Financing Bank	10.6
Rural Electrification and Telephone revolving fund	0.1
Rural Telephone Bank	0.1
Pension Benefit Guaranty Corporation	- *
Postal Service fund	- 0.5
U.S. Railway Association	0.1
TOTAL	10.3

*$50 million or less

NOTE: Since the Export-Import Bank and the elderly housing fund have been returned to the budget, off-budget activity has been dominated by the Federal Financing Bank.

Appendix B

Table 10.--EFFECT OF A ONE PERCENTAGE POINT INCREASE IN THE UNEMPLOYMENT RATE ON OUTLAYS
(dollar amounts in millions)

	First Year	Second Year
Unemployment benefits:		
Regular benefits 1/	1,600	1,600
Extended benefits	600	800
Subtotal	2,200	2,400
Other transfer programs:		
OASI	150	275
DI	50	200
Food stamps	400	425
GI bill	75	125
AFDC	100	200
Medicaid	50	100
Subtotal	825	1,325
Total	3,025	3,725
ADDENDUM		
Unemployment-induced outlays as a percent of total outlays:		
Unemployment benefits	0.49%	0.53%
Other transfers	0.18	0.29
Total	0.67%	0.82%

1/ Includes $100 million for former Federal personnel and ex-servicemen.

2/ Assumes that extended benefits are triggered in some States, but not for the Nation as a whole.

Source: Darwin Johnson, Office of Management and Budget, and Brookings Institution. The estimates are preliminary.

PITTSBURGH NATIONAL BANK

TO SOMC

FROM Jerry L. Jordan PHONE No.

SUBJECT ECONOMIC PROJECTIONS DATE Sept. 7, 1979

I. Tables I and II show projections for 1979 as of the March 1979 meeting and for this meeting.

TABLE I
(percent change)

Projections for 1979 as of March 11, 1979 meeting

	GNP	Output	Deflator	M^1	M^2	V^1	V^2
Q4/78-Q4/79	10.5	2.0	8.3	7.0	8.0	3.3	2.3
1978-1979	11.8	3.3	8.3	6.8	8.3	4.7	3.2

TABLE II
(percent change)

Projections for 1979 as of September 16, 1979 meeting

	GNP	Output	Deflator	M^1	V^1	M^2	V^2	MB	VB
Q4/78-Q4/79	9.1	-0.3	9.4	5.1	3.8	7.6	1.4	7.2	1.8
1978-1979	11.0	1.8	9.1	4.8	5.9	7.3	3.5	7.9	2.9

Output growth is now expected to be less than projected in March, and inflation will be greater. These projections do not assume a strike in the automobile industry. Money growth dropped sharply in the first three months this year, then accelerated rapidly in the subsequent five months.

The two quarter annual rates of change of M1, M2, and monetary base (MB) are shown in attached charts and tables. The contraction of monetary growth, for two-quarter periods, in Q1/79 and Q2/79 was as sharp as in any period in the past thirty years. However, the subsequent re-accleration was equally as sharp. This roller-coaster pattern of monetary growth is similar to that experienced in 1966-67, the time of the first "credit crunch" and "mini-recession".

Other assumptions about 1979, made last March, are holding up. Unemployment is still expected to be in the 5.5 to 6.5 percent range this year. Short-term market interest rates have risen somewhat more than the 75 to 100 basis point rise projected last September, as recognized in March, of this year. Long-term yields have not yet risen by 50 basis points, on balance, but are still expected to do so. Residential construction activity is down as expected; non-residential has risen on balance; real capital spending in 1979 will exceed 1978. The decline in total auto sales may be somewhat more than the 10 percent projected, and the decline has been greater in domestic and less in imports than had been expected. Exports have been strong, as expected, but imports in dollar terms have risen more than projected (because of the world oil price increase) so the trade and current account deficits will not show the expected improvement.

II. Table III shows projections for 1980, based on <u>assumed</u> monetary growth rates, rather than recommended growth rates.

TABLE III
(percent changes)

	Projections for 1980								
	GNP	Output	Deflator	M^1	V^1	M^2	V^2	MB	VB
Q4/79-Q4/80	8.0	-0.4	8.4	4.0	3.9	7.0	0.9	6.2	1.7
1979-1980	8.1	-0.8	8.9	4.9	3.1	7.6	0.4	6.5	1.5

The acceleration of monetary growth that occurred in Q2/79 and Q3/79 is not expected to continue. Pressures on the U.S. dollar in foreign exchange markets, and rising expectations about the trend rate of inflation are causing the Federal Reserve to tolerate a continuing rise in short-term market interest rates in order to slow the growth of bank reserves, the monetary base, money supply and bank credit. It is expected that the growth of the base and monetary aggregates will be reduced, beginning in Q4/79. Furthermore, it is expected that the Federal Reserve will not seek another acceleration of monetary growth in the first half of 1980, even when it becomes clear that a recession is occurring and unemployment is rising. The average rate of inflation will remain quite high at least through the first half of 1980, and the pressures on the dollar's value of forex markets will continue to be a primary concern.

The level of new housing starts at the end of 1979 is expected to be down about 25 percent from the end of 1978, with most of the decline occurring in single family starts. New residential construction activity may contract somewhat further in the first half of next year before beginning a gradual recovery in the second half.

Consumer spending is expected to decline in real terms on balance during 1980, although some increase is likely to occur in the latter part of the year. Non-residential construction and capital spending are expected to decline in real terms for the year, but plans for future spending should be increasing by year-end.

Short-term market interest rates are expected to be on a declining trend throughout 1980, but long-term yields may continue to rise into early 1980 before beginning a gradual decline.

TWO-QUARTER COMPOUNDED ANNUAL RATES OF CHANGE

	M1	M2	MONETARY BASE	M1+
Q1/71-Q3/71	8.2	11.5	8.2	10.1
Q2/71-Q4/71	4.9	8.1	6.6	6.4
Q3/71-Q1/72	5.5	10.2	6.0	7.8
Q4/71-Q2/72	7.7	11.4	7.8	9.1
Q1/72-Q3/72	8.0	10.7	7.8	8.6
Q2/72-Q4/72	9.1	11.0	8.9	9.4
Q3/72-Q1/73	9.0	10.4	10.1	8.3
Q4/72-Q2/73	7.0	9.0	8.8	5.7
Q1/73-Q3/73	5.3	7.9	8.1	4.3
Q2/73-Q4/73	5.4	8.6	7.4	4.6
Q3/73-Q1/74	6.5	10.0	8.1	5.9
Q4/73-Q2/74	5.9	8.9	9.5	5.8
Q1/74-Q3/74	4.1	6.7	8.8	4.9
Q2/74-Q4/74	4.3	6.5	8.5	5.4
Q3/74-Q1/75	3.3	6.6	7.7	5.5
Q4/74-Q2/75	4.0	8.3	7.1	8.5
Q1/75-Q3/75	6.7	10.1	8.3	11.6
Q2/75-Q4/75	5.2	8.7	8.2	9.3
Q3/75-Q1/76	3.8	8.9	7.8	10.4
Q4/75-Q2/76	5.6	10.6	9.2	13.7
Q1/76-Q3/76	5.4	9.7	8.7	10.7
Q2/76-Q4/76	5.9	11.1	7.7	11.5
Q3/76-Q1/77	7.6	12.3	7.9	14.2
Q4/76-Q2/77	7.6	10.4	8.1	10.9
Q1/77-Q3/77	8.3	9.9	9.2	8.5
Q2/77-Q4/77	8.2	9.3	9.5	7.7
Q3/77-Q1/78	7.2	7.7	9.8	6.0
Q4/77-Q2/78	8.2	7.9	9.3	6.2
Q1/78-Q3/78	8.8	9.4	9.0	6.8
Q2/78-Q4/78	6.2	9.0	9.9	4.4
Q3/78-Q1/79	1.0	4.8	7.9	-1.2
Q4/78-Q11/79	2.7	5.3	6.1	-0.7
Q1/79-Q111/79	8.9*	10.4*	8.4*	

* Projected by Pittsburgh National Bank

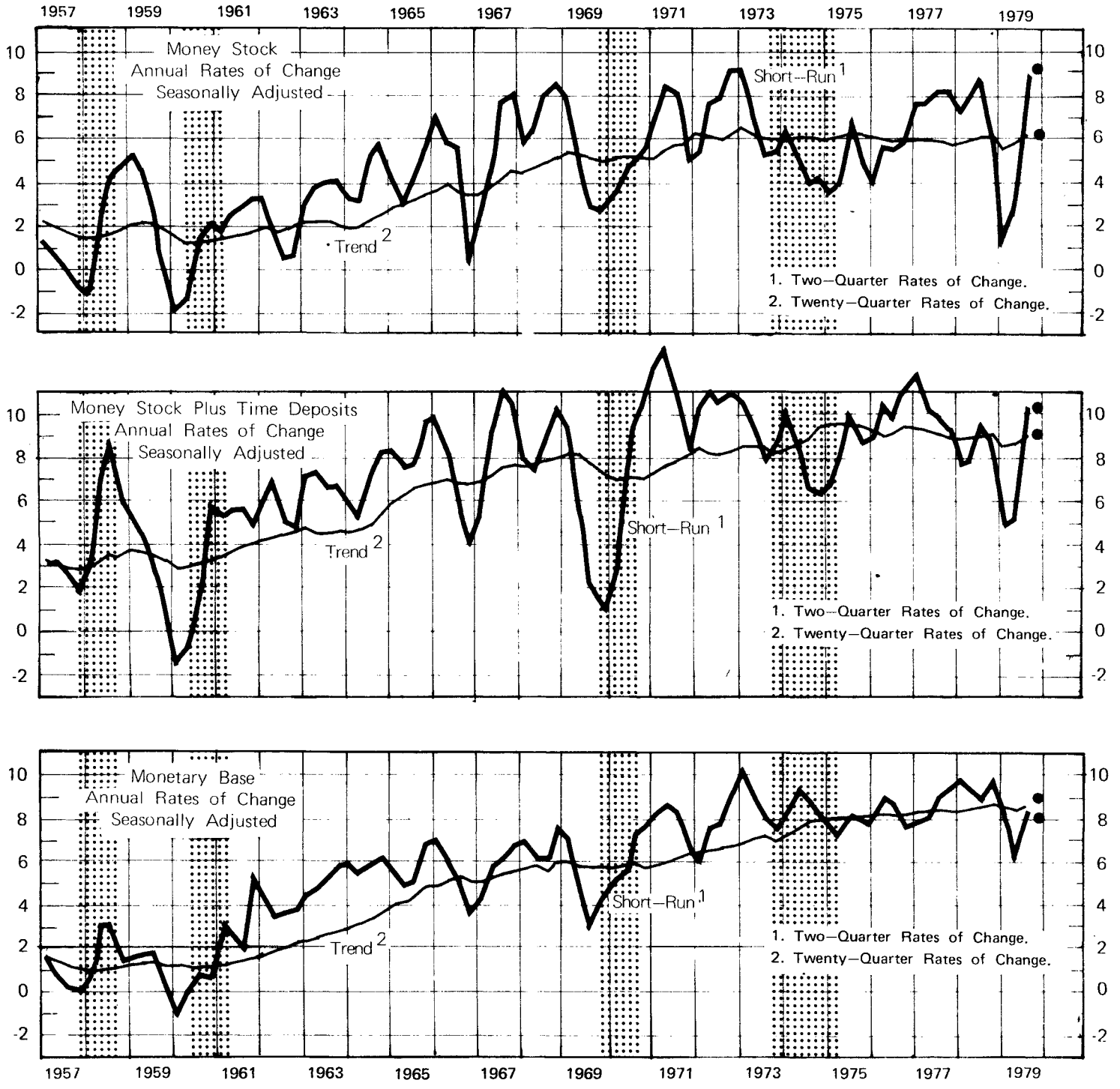
MONEY GROWTH RATES

(% Change from Previous Year)

FROM:	TO:	M1	M2	MONETARY BASE	M1+
1971/Q1	1972/Q1	6.8	10.9	7.1	8.9
Q2	Q2	6.3	9.7	7.2	7.7
Q3	Q3	6.7	10.4	6.9	8.2
Q4	Q4	8.4	11.2	8.3	9.2
1972/Q1	1973/Q1	8.5	10.5	8.9	8.4
Q2	Q2	8.0	10.0	8.9	7.5
Q3	Q3	7.2	9.2	9.1	6.3
Q4	Q4	6.2	8.8	8.1	5.2
1973/Q1	1974/Q1	5.9	9.0	8.1	5.1
Q2	Q2	5.6	8.8	8.4	5.2
Q3	Q3	5.3	8.3	8.4	5.4
Q4	Q4	5.1	7.7	9.0	5.6
1974/Q1	1975/Q1	3.7	6.7	8.2	5.2
Q2	Q2	4.2	7.3	7.8	6.8
Q3	Q3	5.0	8.4	8.0	8.5
Q4	Q4	4.6	8.4	7.6	8.8
1975/Q1	1976/Q1	5.3	9.6	8.0	11.0
Q2	Q2	5.4	9.6	8.7	11.5
Q3	Q3	4.6	9.3	8.3	10.6
Q4	Q4	5.8	10.9	8.4	12.6
1976/Q1	1977/Q1	6.5	11.0	8.3	12.5
Q2	Q2	6.8	10.8	7.9	11.2
Q3	Q3	8.0	11.1	8.5	11.3
Q4	Q4	7.9	9.8	8.8	9.3
1977/Q1	1978/Q1	7.7	8.8	9.5	7.2
Q2	Q2	8.2	8.6	9.4	7.0
Q3	Q3	8.1	8.5	9.4	6.4
Q4	Q4	7.2	8.4	9.6	5.3
1978/Q1	1979/Q1	4.8	7.0	8.4	2.7
Q2	Q2	4.4	7.1	8.0	1.8
Q3	Q3	4.9*	7.5*	8.2*	

* Projected by Pittsburgh National Bank

TRENDS AND FLUCTUATIONS OF MONEY GROWTH



The shaded areas represent periods of business recessions as defined by the National Bureau of Economic Research.

Latest data plotted: 3rd Quarter

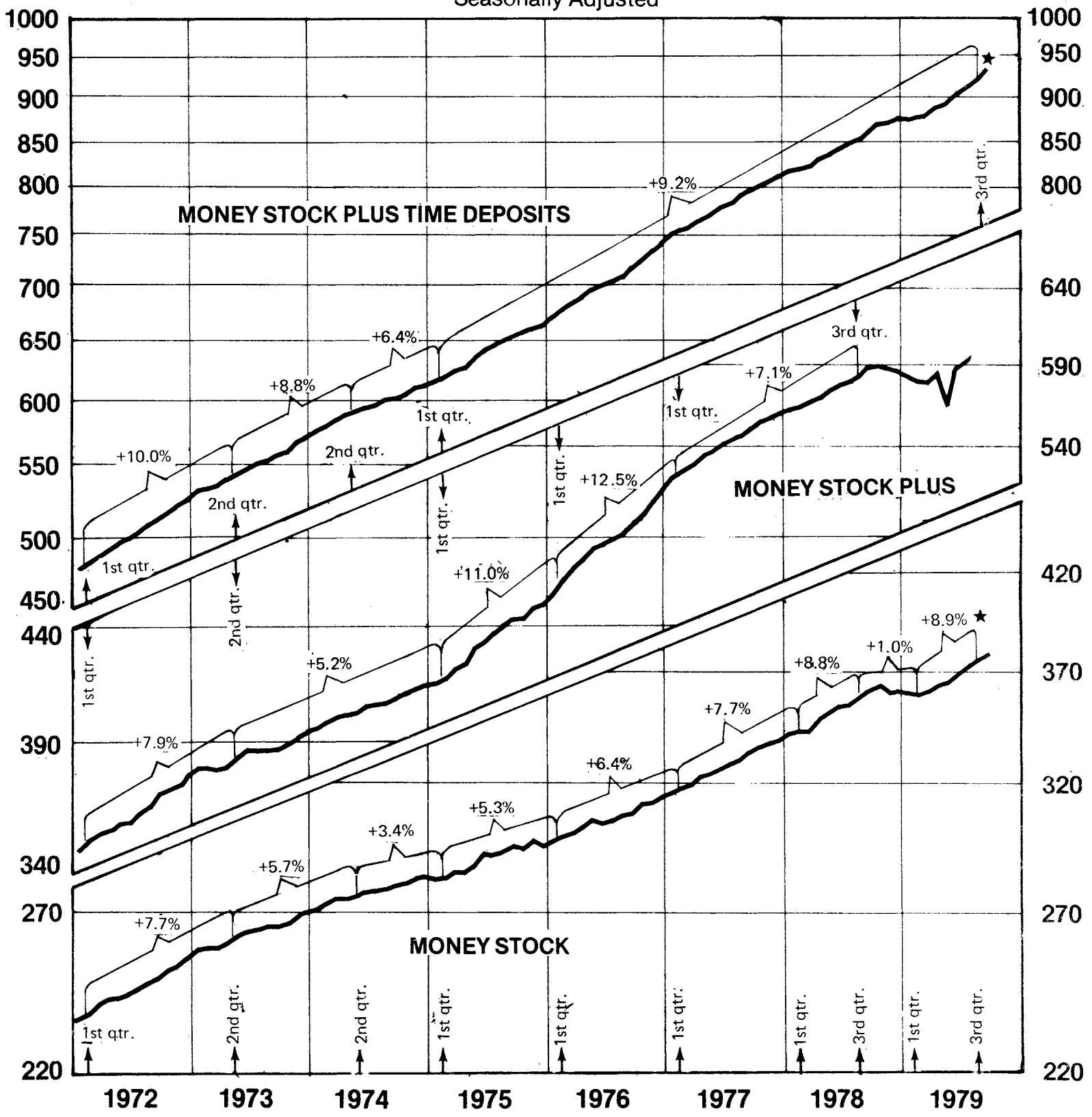
● Projected by Pittsburgh National Bank.

PITTSBURGH NATIONAL BANK

Money Stock

Ratio Scale
Billions of Dollars

Monthly Averages of Daily Figures
Seasonally Adjusted



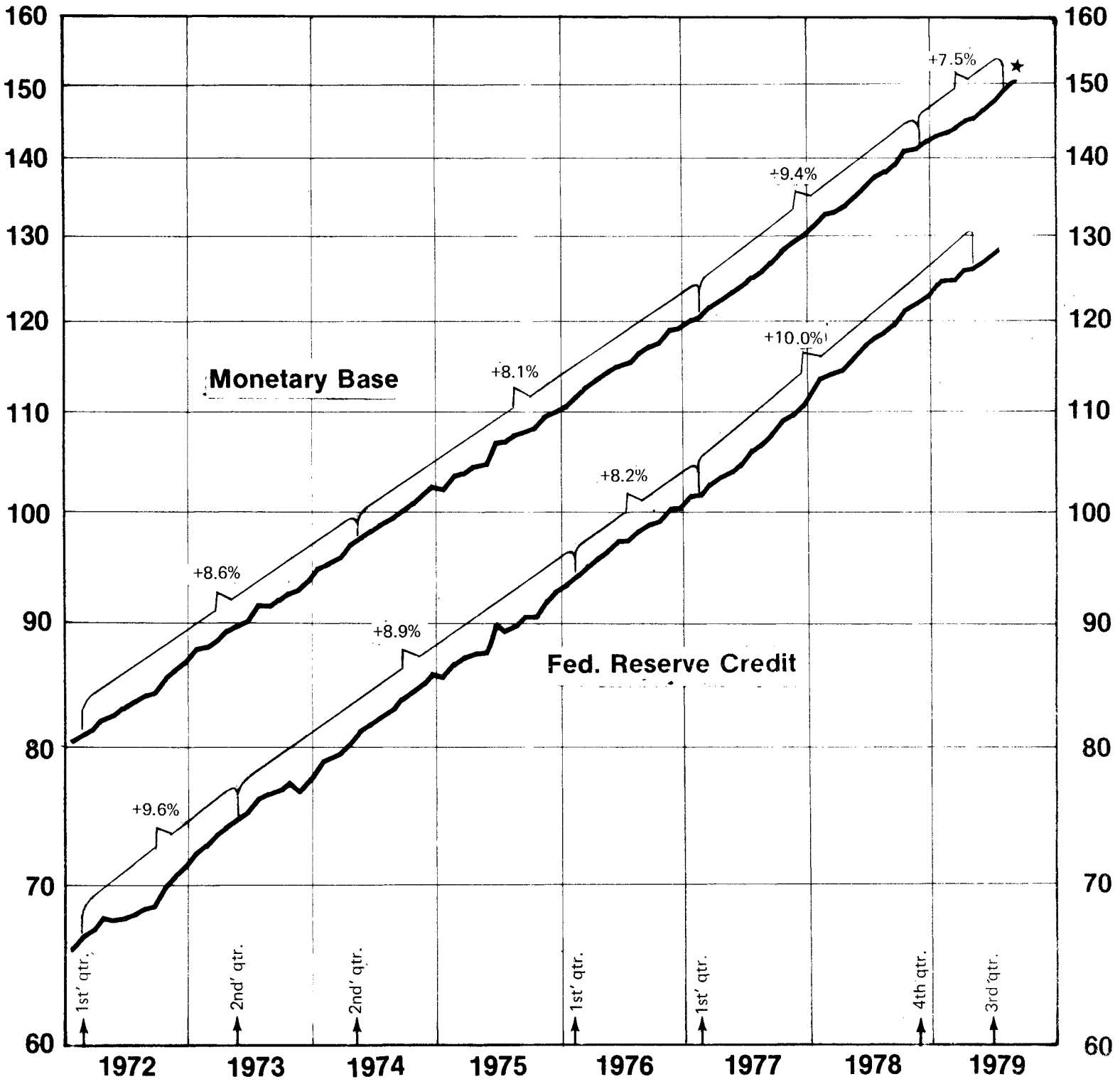
Percentages are annual rates of change for periods indicated.
Latest date plotted: September

★ Projected by Pittsburgh National Bank.

PITTSBURGH NATIONAL BANK

Monetary Base and Fed. Reserve Cre...

Monthly Averages of Daily Figures
Seasonally Adjusted

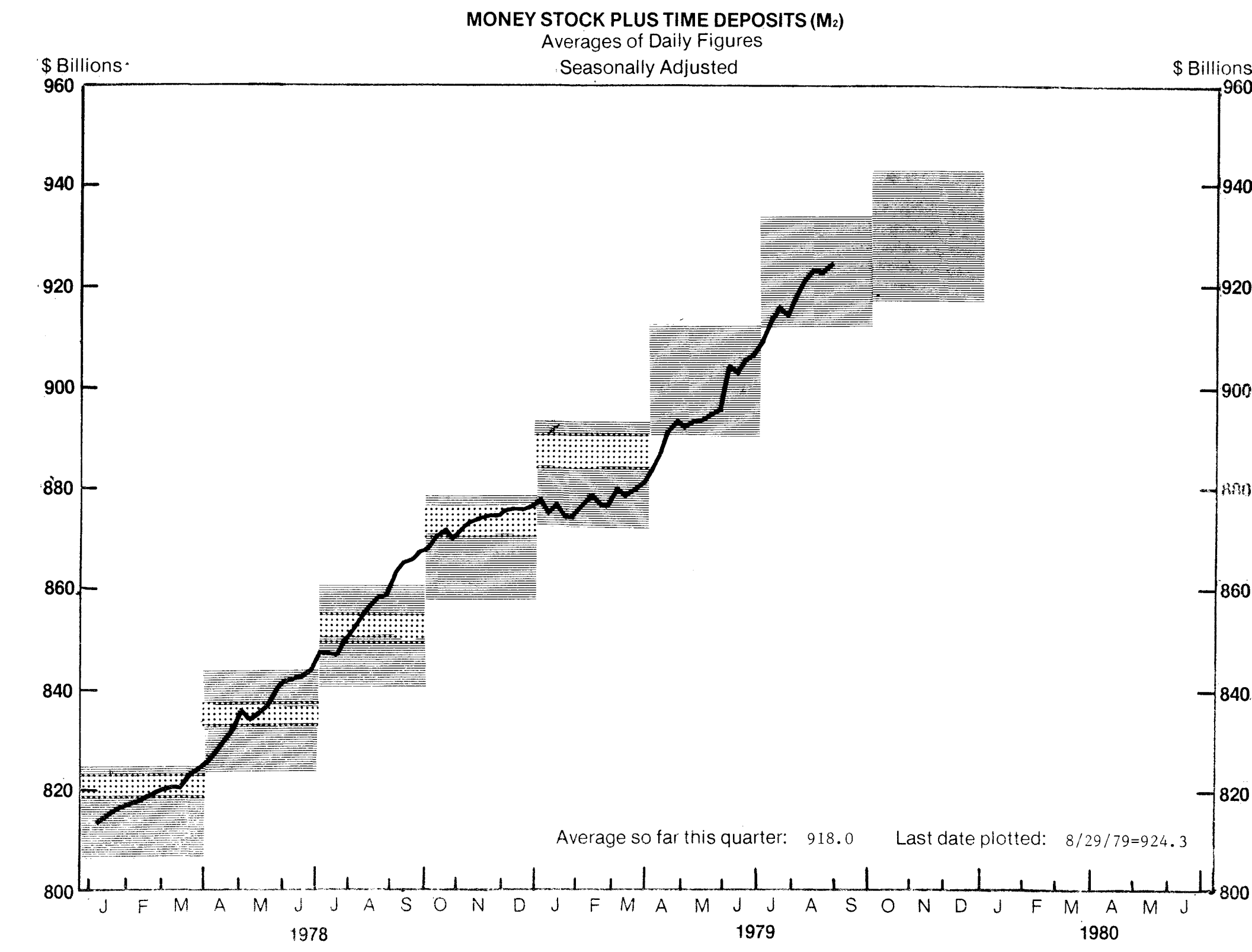


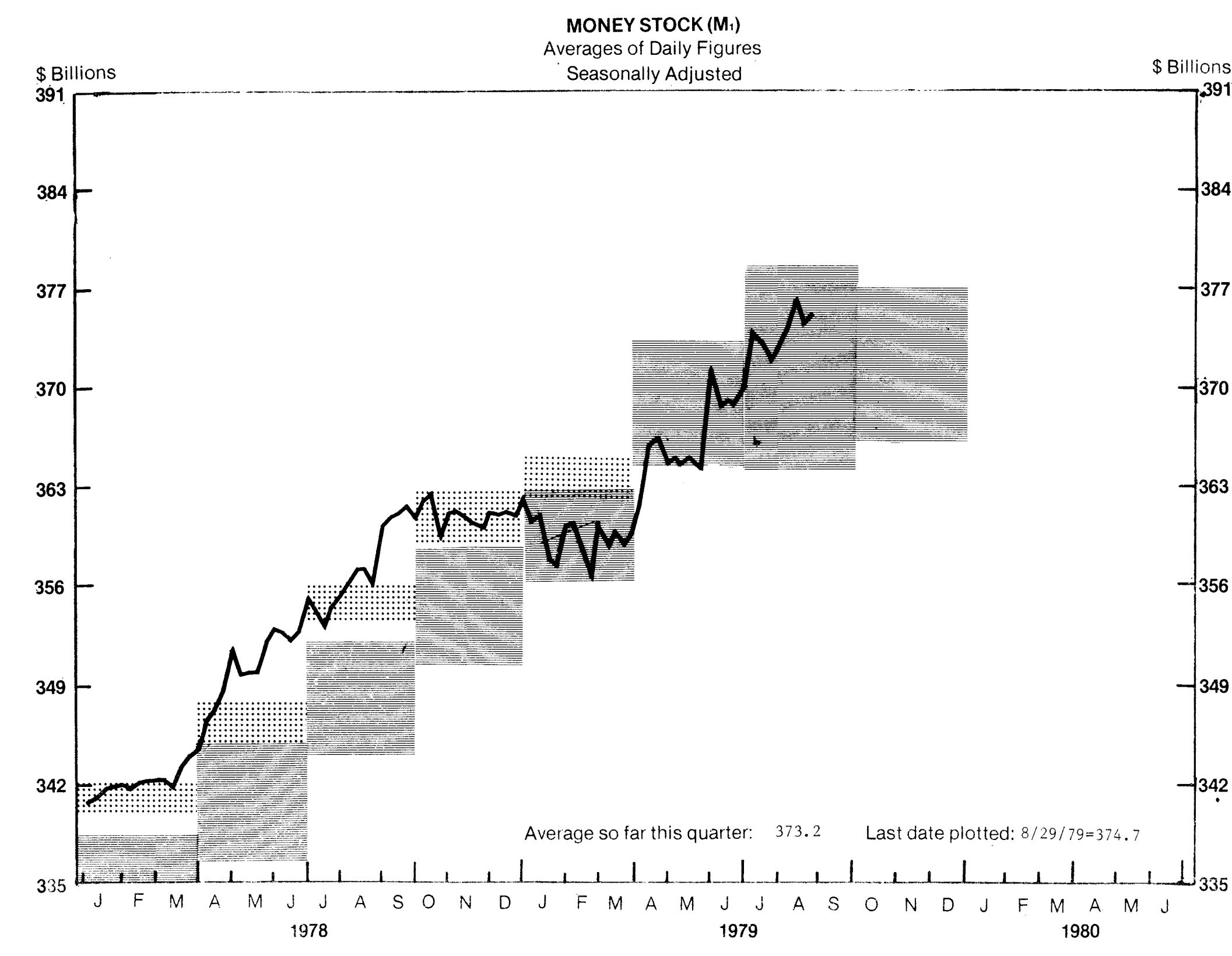
1. Uses of the monetary base are member bank reserves and currency held by the public and nonmember banks. Adjustments are made for reserve requirement changes and shifts in deposits among classes of banks.

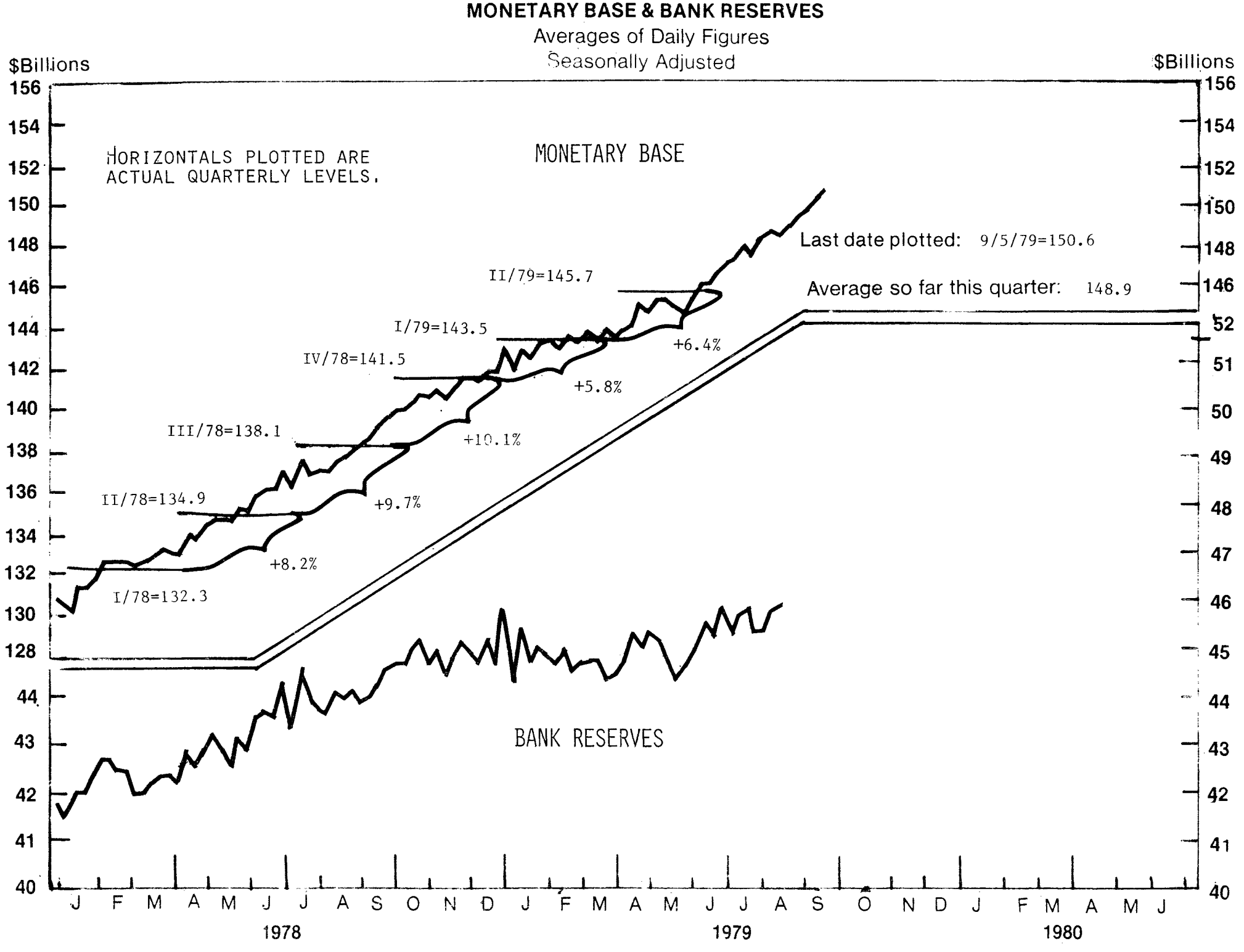
Latest data plotted: September

★ Projected by Pittsburgh National Bank

PITTSBURGH NATIONAL BANK


MONEY STOCK PLUS TIME DEPOSITS (M_2)
Averages of Daily Figures
Seasonally Adjusted
$ Billions
$ Billions
960
940
920
900
880
860
840
820
800
Average so far this quarter: 918.0
Last date plotted: 8/29/79=924.3
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J
1978
1979
1980


MONEY STOCK (M_1)
Averages of Daily Figures
Seasonally Adjusted
$ Billions
$ Billions
391
384
377
370
363
356
349
342
335
Average so far this quarter: 373.2
Last date plotted: 8/29/79=374.7
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J
1978
1979
1980


MONETARY BASE & BANK RESERVES
Averages of Daily Figures
Seasonally Adjusted
$Billions
$Billions
HORIZONTALS PLOTTED ARE ACTUAL QUARTERLY LEVELS.
MONETARY BASE
Last date plotted: 9/5/79=150.6
Average so far this quarter: 148.9
II/79=145.7
I/79=143.5
IV/78=141.5
III/78=138.1
II/78=134.9
I/78=132.3
+6.4%
+5.8%
+10.1%
+9.7%
+8.2%
BANK RESERVES
156
154
152
150
148
146
144
142
140
138
136
134
132
130
128
52
51
50
49
48
47
46
45
44
43
42
41
40
J F M A M J J A S O N D J F M A M J J A S O N D J F M A M J
1978
1979
1980

HARRIS BANK

HEROS
Harris Economic Research Office Service

September 4, 1979

Although the attached anlaysis includes the usual detailed projections, I want to emphasize that the uncertainty concerning projected trends is higher than usual. Much of the uncertainty relates to (1) the extreme volatility in monetary policy and (2) the supply effects emanating from higher oil prices.

As you are well aware, monetary policy moved from massive stimulus in the first 10 months of last year to restraint November '78 through March '79, and back to rapid growth in monetary aggregates since March. The attached table provides several measures of change. The critical assumption in our projection for the balance of the year and into 1980 relates to our assumption of very slow money growth over the balance of the year. If this does not occur, the recession will be short lived, but inflation and interest rates will soar. Recent increases in the fed funds rate suggest that the Federal Reserve is attempting to slow monetary growth, but so far there is very little evidence that the objective has been accomplished.

Once again we have witnessed volatile monetary growth induced by the Federal Reserve's effort to regulate the fed funds rate. To my knowledge there is no evidence in the minutes of the Open Market Committee indicating an intent to induce volatile growth in monetary aggregates.

Beryl W. Sprinkel
Executive Vice President
and Economist

September 4, 1979

MONETARY GROWTH

(Compound Annual Rates of Change)

	Targets	12/77 to 10/78	10/78 to 3/79	3/79 to last 4 weeks
Monetary base*		10.1%	6.2%	9.3%
Bank Reserves*		10.4%	-0.5%	6.2
M_1	1.5%-4.5%	8.1%	-1.2%	10.4
M_2	5%-8%	9.1%	2.7%	12.0

*Adjusted

Source: Federal Reserve Board and St. Louis Federal Reserve Bank

HARRIS BANK

HEROS
Harris Economic Research Office Service

August 10, 1979

ECONOMIC PROSPECTS THROUGH 1980

The downturn in business activity which began earlier this year is continuing into the third quarter. Although a recent increase in monetary growth will have a moderating effect on the downturn temporarily, higher than expected energy costs should offset any short-term stimulus from money. As a result, the recession is still expected to continue into 1980 and to be characterized as moderate.

Monetary Developments - Departing From Script

Although the recession arrived essentially on time (aided in part by energy problems), the recent spurt in the money supply was completely unexpected. The forecast had called for increases averaging 4.3% at an annual rate between the first quarter and fourth quarter of 1979 in the narrowly defined money supply (demand deposits plus currency). This policy would have resulted in a typical recession and left the economy poised for a normal cyclical recovery in early 1980. The pattern was altered when monetary growth soared at an 11% annual rate between March and July. Without any further negative developments, this boost in money would have contributed to a pickup in spending this fall which could have temporarily reversed the economic downturn. As it turns out, the negative impact of sharply higher oil prices is expected to offset the short-run positive impact of rapid money growth. The net result is likely to be an economy which continues to trend downward and remains sluggish for a longer period of time.

Future Monetary Growth - Returning to the Script

A key assumption in the present forecast is that the Federal Reserve will restrict M_1 growth to an annual rate of just under 5% between mid-year and the end of 1979. All of the arguments previously presented for tight money during 1979--inflation is public enemy number one, defense of the dollar is crucial, etc.--are still valid. In addition, there is the appointment of Paul Volcker as Fed Chairman. It is crucial that Mr. Volcker prove immediately that he is serious about reducing inflation by controlling monetary growth if the Fed is to be viewed as anything other than an engine for inflation. If its actions fail to control monetary growth when unemployment is still less than 6%, the Fed's credibility would be completely gone.

In spite of the latest forecast of renewed monetary restraint, nagging doubts about the future course of Fed actions remain. President Carter's four appointments to the Fed all share his sensitivity to the unemployment problem along with a preference for viewing interest rates instead of money as a guide to policies. Although not considered the

most likely development, it is still possible that Fed actions will be geared toward minimizing the influence of the present recession by continuing a policy of rapid monetary growth. If this occurs, inflation would remain in the 10%-15% range in 1980, interest rates would soar and the end result would be a protracted downturn in business activity throughout 1980.

Interest Rates - Will Recession or Inflation Dominate?

The major question regarding interest rate movements is whether the recessionary forces now underway will reduce credit demands sufficiently to lower interest rates or whether inflationary forces will drive them up further. With respect to short-term interest rate developments, it appears that rates might have to go up another notch (25 to 75 basis points) in order to slow monetary growth significantly. Once growth is slowed, short-term rates will fall. The turning point is expected to occur within the next two months. As for long-term rates, the cyclical forces associated with the present recession are expected to dominate with rates declining by approximately 75 basis points from present levels. This would take the new issue AA industrial rate from 9¼% at present to 8½% at the trough.

Although there is considerable uncertainty over both monetary developments and inflationary expectations, past experience supports the view that during recessions cyclical factors dominate movements in long-term rates. In 1970 a mild recession in the U.S. was accompanied by a 200 basis point decline in long-term rates and the more severe 1974 downturn helped to contribute to a 160 basis point reduction in rates. The reduced magnitude of decline last time around suggests that "rational expectations" were at work mitigating the decline. Although expectations of renewed stimulus might be expected to prevent any significant decline in rates during the present recession, evidence from abroad shows that cyclical forces tend to dominate movements in long-term rates. For example, in the U.K. long-term rates dropped by 280 basis points during 1975 as business activity declined. This occurred in spite of a sharp acceleration in both inflation and monetary growth. Also, in West Germany during 1974, long-term rates fell after six months of declining business activity in spite of little improvement in inflation and sharp increases in monetary growth.

The key to long-term interest rate developments over the next six to nine months rests with future Fed policy. If, in contrast to our assumption, Fed policies attempt to minimize the discomfort of the recession by a policy of renewed monetary growth, then recessionary forces would give way to rapid increases in spending and long-term rates would quickly reverse direction and move higher.

Energy Adjustments - A $20 Billion Shift

Over time an increase in oil prices *per se* will neither add to inflation nor reduce spending. Higher oil prices initially lead to more spending on oil products, but with no change in income, this increase must be associated with less spending on non-oil products. Although energy prices are presently increasing faster than inflation, non-energy prices will rise slower than inflation as demand is reduced in those areas

Consumer spending on purchases of non-oil related items will be lowered at first as those funds go to oil producers. However, these funds eventually will be funneled back into the economy as the recipients of oil revenues spend their unanticipated gains. The magnitude of this impact is estimated to be approximately $20 billion per year this time around. That is, some $20 billion more per year than had been anticipated will be transferred from the income of U.S. oil consumers to oil producers. During the transition stage, as consumers cut back on purchases to pay for higher price energy products and before the recipients of these profits have spent the funds, there will be lower spending and higher inflation. About half of the estimated $20 billion energy adjustment is assumed to raise inflation during the remainder of 1979 and half is assumed to reduce nominal spending as the shift in income serves to rearrange buying patterns. Some positive adjustment is made for both inflation and spending in 1980 as the impact of the oil transfer works its way through the economy.

Fiscal Policy

As unemployment increases in the upcoming months, prospects for a tax cut will improve. The present forecast assumes that taxes are reduced by approximately $30 billion from what would have been generated by present tax laws. In terms of the mix, roughly one third of the reduction is likely to be geared toward the corporate sector, probably through accelerated depreciation and reduction in planned social security increases. The remainder will represent a cut in personal taxes with at least a portion of this applied to social security taxes.

Corporate Profits

Extremely high inflation rates have taken their toll on corporate profits. Revised GNP figures show that after-tax profits of nonfinancial corporations adjusted for replacement depreciation and inventory profits fell to 4.9% of gross corporate income during 1976-78. This compares with 5.1% during the previous expansion. The continued deterioration in this ratio suggests that profits have not flowed through to the bottom line during the course of the most recent business expansion. Although the proportion of corporate income going for dividend payments averaged 3.4% during the recent expansion (up from 3.2% during the previous expansion), the proportion of income retained by corporations dropped to 1.6% from 1.9% during the 1971-73 expansion. This reduction in retained earnings represents a discouraging development which has adverse implications for corporate and, in turn, economic growth in future years.

SUMMARY

The U.S. economy has entered the first stage of an inflationary recession. The downturn is expected to be moderate in terms of length and depth with industrial production declining close to 10% from peak to trough. However, the uncharacteristic behavior of monetary policy in recent months bears close watching and suggests that more than the usual amount of uncertainty exists with respect to the economy and the outlook for financial markets.

Robert J. Genetski
Vice President and Economist

8/7/79

ECONOMIC OUTLOOK
(BILLIONS OF DOLLARS--SEASONALLY ADJUSTED ANNUAL RATES)

	ACTUAL			FORECAST						YEARS			
	1978:4	1979:1	1979:2	1979:3	1979:4	1980:1	1980:2	1980:3	1980:4	1977	1978	1979	1980
GROSS NATL PRODUCT	2235.2	2292.1	2327.2	2372.7	2402.8	2438.9	2500.4	2576.7	2653.2	1899.5	2127.6	2348.7	2542.3
%CH	14.8	10.6	6.3	8.1	5.2	6.1	10.5	12.8	12.4	11.6	12.0	10.4	8.2
CONSTANT DOLLAR GNP	1426.6	1430.6	1418.8	1411.0	1396.5	1388.3	1396.6	1412.8	1429.7	1340.5	1399.2	1414.2	1406.9
%CH	5.6	1.1	-3.3	-2.2	-4.0	-2.3	2.4	4.7	4.9	5.3	4.4	1.1	-0.5
PRICE DEFLATOR	1.5668	1.6022	1.6403	1.6816	1.7206	1.7567	1.7903	1.8238	1.8558	1.4167	1.5200	1.6612	1.8067
%CH	8.7	9.3	9.9	10.5	9.6	8.7	7.9	7.7	7.2	6.0	7.3	9.3	8.8
CONSUMPTION EXPENDITURES	1415.4	1454.2	1474.2	1509.2	1532.4	1563.2	1602.8	1653.6	1699.9	1210.0	1350.8	1492.5	1629.9
%CH	14.2	11.4	5.6	9.9	6.3	8.3	10.5	13.3	11.7	11.0	11.6	10.5	9.2
DURABLES	212.1	213.8	207.3	210.0	204.0	205.0	215.0	235.0	250.0	178.8	200.3	208.8	226.3
%CH	18.0	3.2	-11.6	5.3	-10.9	2.0	21.0	42.7	28.1	13.6	12.0	4.2	8.4
NONDURABLES	558.1	571.1	578.7	591.8	603.8	616.0	628.0	639.9	651.9	481.4	530.6	586.4	634.0
%CH	16.9	9.6	5.4	9.4	8.4	8.3	8.0	7.8	7.7	8.4	10.2	10.5	8.1
SERVICES	645.1	669.3	688.2	707.4	724.6	742.2	759.8	778.7	798.0	549.8	619.8	697.4	769.7
%CH	10.6	15.9	11.8	11.6	10.1	10.1	9.8	10.3	10.3	12.5	12.7	12.5	10.4
INVESTMENT EXPENDITURES	370.5	373.8	391.3	385.8	376.5	367.8	380.5	398.2	416.0	303.3	351.5	381.8	390.6
%CH	17.1	3.6	20.1	-5.5	-9.3	-8.9	14.5	19.9	19.1	24.8	15.9	8.6	2.3
NONRES FIXED EXPEND	236.1	243.4	247.1	254.0	256.6	258.0	259.4	262.9	268.2	189.4	221.1	250.3	262.1
%CH	19.3	13.0	6.2	11.6	4.2	2.2	2.2	5.5	8.3	14.9	16.7	13.2	4.7
PRODUCERS DUR EQUIP	151.8	158.5	156.9	160.6	161.4	161.6	162.6	165.1	169.3	126.8	144.6	159.4	164.7
%CH	15.8	19.0	-4.0	9.7	2.0	0.5	2.5	6.3	10.6	17.9	14.1	10.2	3.3
BUSINESS STRUCTURES	84.4	84.9	90.2	93.4	95.2	96.4	96.8	97.8	98.9	62.6	76.5	90.9	97.5
%CH	25.9	2.4	27.3	15.1	7.9	5.1	1.7	4.2	4.6	9.3	22.2	18.8	7.2
RES FIXED EXPEND	113.7	111.2	112.9	111.8	109.9	110.3	118.1	127.3	135.8	91.9	108.0	111.5	122.9
%CH	13.3	-8.5	6.3	-3.8	-6.6	1.5	31.4	35.0	29.5	35.0	17.5	3.2	10.3
INVENTORY CHANGE	20.6	19.1	31.4	20.0	10.0	-0.5	3.0	8.0	12.0	21.9	22.3	20.1	5.6
NET EXPORTS	-4.5	4.0	-7.0	-2.0	0.0	4.3	4.0	2.0	1.0	-9.9	-10.3	-1.3	2.8
GOVT PURCHASES	453.8	460.1	468.7	479.7	493.9	503.6	513.1	522.9	536.3	396.2	435.6	475.6	519.0
%CH	12.2	5.7	7.7	9.7	12.4	8.1	7.8	7.9	10.7	9.7	9.9	9.2	9.1
FEDERAL	159.0	163.6	162.9	167.2	174.6	177.1	179.7	182.3	188.3	144.4	152.6	167.1	181.8
%CH	18.8	12.1	-1.7	11.0	18.9	5.9	6.0	5.9	13.8	11.3	5.7	9.5	8.8
MILITARY	101.2	103.4	106.0	108.8	112.9	114.9	117.0	119.1	123.6	93.8	99.0	107.8	118.7
OTHER	57.8	60.2	56.9	58.4	61.7	62.2	62.7	63.2	64.7	50.6	53.6	59.3	63.2
STATE & LOCAL	294.8	296.5	305.8	312.5	319.3	326.5	333.4	340.6	348.0	251.8	283.0	308.5	337.1
%CH	8.9	2.3	13.1	9.1	9.0	9.3	8.7	8.9	9.0	8.7	12.4	9.0	9.3

NOTE: PERCENTAGE CHANGES AT ANNUAL RATES; PRELIMINARY DATA FOR 79:2

8/7/79

ECONOMIC OUTLOOK
(BILLIONS OF DOLLARS--SEASONALLY ADJUSTED ANNUAL RATES)

	ACTUAL			FORECAST						YEARS			
	1978:4	1979:1	1979:2	1979:3	1979:4	1980:1	1980:2	1980:3	1980:4	1977	1978	1979	1980
PRETAX PROFITS*	227.4	233.3	222.2	214.3	201.3	193.1	197.0	205.0	210.0	177.1	206.0	217.8	201.3
%CH	32.4	10.8	-17.7	-13.5	-22.1	-15.3	8.3	17.3	10.1	13.5	16.3	5.7	-7.6
TAX LIABILITY	95.1	91.3	87.3	84.2	79.1	67.2	68.6	71.3	73.1	72.6	84.5	85.5	70.0
%CH	39.5	-15.1	-16.3	-13.5	-22.1	-47.9	8.3	17.3	10.1	13.8	16.4	1.1	-18.1
AFTER TAX PROFITS	132.3	142.0	134.9	130.1	122.2	125.9	128.4	133.7	136.9	104.5	121.5	132.3	131.2
%CH	27.1	32.7	-18.6	-13.5	-22.1	12.7	8.3	17.3	10.1	13.4	16.3	8.9	-0.8
AFT TAX PROF ADJ[1]	89.8	87.6	83.8	82.6	80.6	87.1	89.1	92.8	95.3	77.3	83.2	83.6	91.1
%CH	9.4	-9.4	-16.4	-5.6	-9.3	36.5	9.7	17.2	11.5	22.7	7.6	0.6	8.9
DIVIDENDS	49.7	51.5	52.3	53.8	54.6	55.5	56.5	57.5	58.5	42.1	47.1	53.1	57.0
%CH	16.9	15.3	6.4	12.0	6.1	6.8	7.4	7.3	7.1	12.3	12.0	12.5	7.4
PERSONAL INCOME	1803.1	1852.6	1892.6	1934.0	1967.0	2000.0	2039.0	2086.0	2139.0	1531.6	1717.4	1911.6	2066.0
%CH	14.7	11.4	8.9	9.0	7.0	6.9	8.0	9.5	10.6	10.9	12.1	11.3	8.1
TAX & NONTAX PAYMENT	278.2	280.4	290.9	296.4	304.1	300.9	292.5	307.9	318.9	226.5	259.0	292.9	305.1
%CH	19.6	3.2	15.8	7.8	10.8	-4.1	-10.7	22.8	15.1	14.9	14.4	13.1	4.1
DISPOSABLE INCOME	1524.8	1572.2	1601.7	1637.6	1662.9	1699.1	1746.5	1778.1	1820.1	1305.1	1458.4	1618.6	1761.0
%CH	13.7	13.0	7.7	9.3	6.3	9.0	11.6	7.4	9.8	10.2	11.7	11.0	8.8
PERSONAL OUTLAYS	1453.4	1493.0	1514.5	1549.7	1572.9	1603.7	1643.3	1694.6	1741.3	1240.2	1386.4	1532.5	1670.7
%CH	14.3	11.4	5.9	9.6	6.1	8.1	10.2	13.1	11.5	11.1	11.8	10.5	9.0
PERSONAL SAVINGS	71.5	79.2	87.2	87.9	90.0	95.4	103.2	83.5	78.8	65.0	72.0	86.1	90.2
%CH	3.4	50.5	46.9	3.2	9.9	26.2	36.9	-57.1	-20.7	-5.3	10.9	19.5	4.8
SAVING RATE(%)	4.7	5.0	5.4	5.4	5.4	5.6	5.9	4.7	4.3	4.9	5.0	5.3	5.1
EMPLOYMENT	95.616	96.596	96.415	97.000	96.400	96.200	96.000	96.300	96.900	90.543	94.381	96.603	96.350
%CH	3.8	4.2	-0.7	2.4	-2.5	-0.8	-0.8	1.3	2.5	3.5	4.2	2.4	-0.3
LABOR FORCE	101.524	102.475	102.295	103.200	103.700	104.000	104.300	104.700	105.100	97.375	100.417	102.918	104.525
%CH	3.1	3.8	-0.7	3.6	2.0	1.2	1.2	1.5	1.5	2.8	3.1	2.5	1.6
UNEMPLOYMENT RATE(%)	5.833	5.733	5.733	6.008	7.040	7.500	7.958	8.023	7.802	7.025	6.000	6.128	7.821
PRODUCTIVITY*	1.186	1.177	1.160	1.156	1.149	1.144	1.147	1.154	1.160	1.165	1.178	1.160	1.151
%CH	1.0	-3.0	-5.7	-1.4	-2.4	-1.7	1.1	2.5	2.1	1.8	1.1	-1.4	-0.8
INDUSTRIAL PRODUCTION	1.497	1.515	1.511	1.478	1.432	1.400	1.408	1.433	1.459	1.371	1.451	1.484	1.425
%CH	7.6	4.7	-1.1	-8.4	-11.9	-8.6	2.3	7.3	7.5	5.6	5.8	2.3	-4.0

NOTE: PROFITS FOR 79:2 ARE ESTIMATES; PRODUCTIVITY IS MEASURED AS OUTPUT PER HOUR--NONFARM BUSINESS

1) AFTER TAX PROFITS ADJUSTED TO EXCLUDE INVENTORY PROFITS AND ALLOW FOR DEPRECIATION AT REPLACEMENT COST

	ACTUAL				FORECAST					YEARS			
	1978:4	1979:1	1979:2	1979:3	1979:4	1980:1	1980:2	1980:3	1980:4	1977	1978	1979	1980
INTEREST RATES													
NEW ISSUE AA INDUS BONDS	9.000	9.110	9.420	9.200	8.900	8.500	8.500	8.500	8.750	7.910	8.735	9.208	8.563
NEW ISSUE AA UTIL BONDS	9.370	9.720	9.930	9.700	9.400	9.000	9.000	9.000	9.250	8.325	9.098	9.608	9.063
PRIME RATE	10.810	11.750	11.717	11.000	11.000	9.000	8.500	8.500	8.400	6.824	9.057	11.567	8.600
COMMERCIAL PAPER 4-6 MOS	9.897	10.097	9.853	10.300	9.750	8.500	8.000	8.000	7.700	5.612	7.994	10.000	8.050
MONETARY BASE-(MB)	141.4	143.5	145.6	148.6	150.1	152.1	154.9	157.9	161.0	124.9	136.7	146.9	156.5
%CH	10.0	5.9	6.1	8.5	4.1	6.0	7.0	8.0	8.1	8.4	9.5	7.5	6.5
VELOCITY OF MB	15.804	15.977	15.904	15.967	16.000	16.014	16.142	16.319	16.480	15.211	15.561	15.904	16.230
%CH	4.3	4.4	0.2	-0.4	1.0	0.1	3.2	4.4	4.0	2.9	2.3	2.7	1.6
MONEY SUPPLY-(M1)	361.0	359.1	365.9	374.0	376.0	381.5	388.0	395.5	403.5	327.3	352.8	368.8	392.1
%CH	4.2	-2.1	7.8	9.1	2.2	6.0	7.0	8.0	8.3	7.3	7.8	4.5	6.3
VELOCITY OF M1	6.192	6.303	6.360	6.344	6.390	6.393	6.444	6.515	6.575	5.802	6.029	6.369	6.402
%CH	10.1	12.9	-1.5	-1.0	3.0	0.2	3.3	4.5	3.8	4.0	3.9	5.7	1.0
M1-ADJUSTED 1)	366.0	368.4	375.4	383.7	385.7	391.4	398.1	405.8	413.9	327.3	354.0	378.3	402.3
%CH	10.1	2.6	7.8	9.1	2.1	6.0	7.0	8.0	8.2	7.3	8.2	6.9	6.3
VELOCITY OF M1-ADJ	6.107	6.222	6.199	6.184	6.230	6.231	6.281	6.350	6.410	5.802	6.007	6.209	6.318
%CH	4.2	7.7	-1.4	-1.0	3.0	0.1	3.2	4.5	3.9	4.0	3.5	3.3	1.8
CPI-ALL URBAN	2.020	2.074	2.141	2.198	2.251	2.303	2.353	2.399	2.443	1.816	1.955	2.166	2.375
%CH	9.1	11.1	13.6	11.0	10.0	9.6	9.0	8.1	7.5	6.5	7.7	10.8	9.6
AUTO SALES 2)	11.100	11.667	10.633	10.500	9.500	9.500	9.900	10.700	11.400	11.184	11.293	10.575	10.375
DOMESTIC	9.200	9.300	8.167	8.200	7.500	7.500	7.900	8.600	9.300	9.132	9.305	8.292	8.325
IMPORTS	1.900	2.300	2.533	2.300	2.000	2.000	2.000	2.100	2.100	2.066	1.992	2.283	2.050
HOUSING STARTS 2)	2.078	1.615	1.817	1.600	1.500	1.600	1.800	1.900	1.950	1.963	2.007	1.638	1.813

1) M1 ADJUSTED BY HARRIS BANK FOR INSTITUTIONAL AND STRUCTURAL CHANGES BELIEVED TO BE AFFECTING REPORTED M1 DATA
2) IN MILLIONS OF UNITS-SEASONALLY ADJUSTED ANNUAL RATES

September 12, 1979

The International Dimension

by Wilson E. Schmidt
Virginia Polytechnic Institute & State University

The near term foreign influences on the domestic economy are likely to exacerbate our problems at home.

First, policy makers may be led to expansionary policies not otherwise justified because the measured output of the economy, namely real GNP, will appear to be weaker than it actually is.

The error in the measurement of real GNP stems from a long standing mistake in methodology at a time when international forces exagerate the error. The Commerce Department deflates the bulk of our exports of goods and services with an index of export prices. But investment income receipts (excluding reinvested earnings which are not counted in the GNP) are deflated by an index of import prices which have been rising more rapidly through June than export prices because of petroleum developments. As there is no difference between the economic effects of investment income receipts and the other exports of goods and services, the different deflation methods are unjustified.

The error is compounded in the deflation of imports of goods and services. These are deducted from the total value of output to determine the GNP because they are unavoidably included in the reported data. While the bulk of such imports are deflated by the Commerce Department by an index of import prices, investment income payments to foreigners (excluding reinvested calculation) are deflated by export prices. By overstating real imports, which are deducted, this procedure understates the real GNP.

All petroleum imports have a weight of almost 30% in the index of import prices. As measured by Commerce for GNP purposes, investment income receipts

and payments together equal about 1.92% of nominal GNP in the first half of 1979. With the prices of all petroleum imports expected to rise by 60% in 1979, the understatement of the real GNP will be 35/100 of one percent.

Second, the fundamentals suggest that the dollar will depreciate on the foreign exchange market. At our last meeting I summarized the work of Peter Hooper and Barbara Lowery of the Fed staff who estimated that a decline in the real effective exchange rate (which is the average change in the rate adjusted for changes in consumer prices here and abroad, multilaterally weighted) of 10% leads to a 1.5% to 1.75% increase in consumer prices within 2-3 years with about half of the impact coming in the first year. Though we correctly anticipated the rise in the real effective rate for the dollar from 81.8 in February to 82.4 in August we probably are still feeling the effects of the long slide from 95.4 at the end of 1976.

To analyze the outlook for the dollar, I calculate the money supply growth rates for a number of countries which are consistent with exchange rate stability over the longer run, using a modified version of the methodology employed by Professor Pieter Kortweg at the last Shadow European Economic Policy Committee meeting, and compare the results with actual growth rates of money supplies. I assume an underlying rate of inflation in the United States of 10%. For exchange rate stability to prevail, prices in other countries should rise by 10% plus or minus any change required by other underlying forces. These other underlying forces are taken to be measured by the annual average deviation of the exchange rate from purchasing power parity in 1974-1978. Having calculated the "consistent inflation rate," the next step is to calculate the money growth rate necessary to achieve that target. Using the period 1974-78, this requires three steps: 1) Divide the rate of inflation by the growth in money per unit of output to obtain the "inflation-money multiplier;"

2) Divide the "consistent inflation rate" by the "inflation-money multiplier" to obtain the "required growth in money per unit of output" which will achieve the "target" inflation rate; 3) Add to the "required growth in money per unit of output" the trend in output to obtain the "required growth in money." Supplementing Kortweg's data with the figures for Canada and Japan and updating his 1978 figures Table I displays the "consistent inflation rates," the actual inflation rates over the last year with the parentheses indicating the last month for which data are available, the "required growth in money," and the actual money growth. It is quite apparent that Germany and the Netherlands are far below the "required growth in money." These two countries have a weight of almost one third in the effective exchange rate index for the dollars. Only Italy errs greatly on the other side; its weight is 9%. On this analysis, the outlook for the dollar is dim. But if one constructs a pressure index by taking the difference between the required rate and actual rate of money growth as a percentage of the required rate, weighting it multilaterally, the index suggests little change in the dollar. I am inclined to put more weight on the role of the outliers despite this result.

The dollar often gets into trouble when there are changes in exchange rates among the European countries. Eight of the nine members of the European Economic Community are members of the recently established European Monetary System which provides narrow margins for fluctuations in the exchange rates among them (2¼% on either side of the central cross rate) except for Italy whose margin is 6% on either side. The United Kingdom decided not to participate in the margins part of the System. Table II displays the results of replicating the previous analysis for the EMS countries alone on the assumption that the underlying rate of inflation in Germany is 5%. It shows that Belgium, Germany, and the Netherlands, are below the

required rate of monetary growth to maintain exchange rate stability within the EMS while the other members are above it. This portends exchange rate tension within the EMS which in turn may lead to trouble for the dollar.

Current research suggests that, while the exchange rate tends towards purchasing power parity in the longer run, in the short run it depends on the demand and supply of the dollar relative to the demand and supply of foreign currencies, the so-called asset approach. The supply of nominal money is determined by the monetary authorities while the real supply is determined by the behavior of prices and the nominal supply together. The demand for money is seen as a decreasing function of interest rates, an increasing function of income, and a decreasing function of inflationary expectations.

As noted above, the dollar seems to be above its purchasing power parity and therefore the long run forces will depress it. Assuming that the shorter run forces were at work since we last met, would they have held the dollar up or down?

In what follows we compare developments between our last meeting and now in the United States and those in the Big Six plus Sweden and the Netherlands, weighted by their multilateral weights in our effective exchange rate.

On the supply side, the growth of real money abroad, while reduced from 5.9% before our last meeting, is still positive at 2.8%. In the United States the growth in real money has risen from -4% before our last meeting but is still negative at -2%. The supply forces should have caused an appreciation of the dollar.

Among the factors affecting the demand for money, three month interest rates rose from 6.1% to 8.9% or by 280 basis points while the three month CD rate in the United States rose from 10.3% to 10.9% or sixty basis points. By reducing the demand for money abroad by more than in the United States,

these relative interest rate shifts should have appreciated the dollar.

Industrial production is a proxy for the role of income in determining the demand for money. It slipped slightly abroad from 6.3% to 6.1% while it fell from 8.6% to 4.5% in the United States. The relative decline in the demand for money in the United States should have forced a depreciation in the dollar.

Inflationary expectations have been found by J. Frankel to have a powerful effect on the exchange rate. He measures them by the long term government bond rate. Since we last met, that rate has risen from 8.3% to 8.6% abroad while it has hardly changed in the United States. With higher expectations of inflation abroad, reducing the demand for money there, the dollar should have appreciated.

The bulk of the short run forces should have been appreciating the dollar but in fact it fell slightly from 88.3% last February to 87.4 in the last two weeks of August. Since the short run forces could not hold the dollar up, it seems likely to decline in the next six months. Purchasing power parity is having its way. This judgement is confirmed by the market place where the forward premium, i.e., the extra dollars paid for foreign currencies for delivery in the future compared with the dollars paid for them now, is still positive at 2.5%, though reduced from 3.6% before the last meeting.

TABLE 1

Consistent Inflation Rates & Required Money Growth Rates
(U.S. Inflation = 10%)

Country	Consistent Inflation Rate	Actual Inflation Rate	Required Money Growth	Actual Money Growth
Belgium	15.30	4.5 (6)	8.0	5.4 (3)
Canada	8.1	8.5 (7)	5.3	8.0 (6)
Denmark	14.7	7.0 (4)	11.3	16.5 (2
France	12.0	10.5 (7)	7.3	11.5 (2)
Germany	12.2	4.5 (7)	31.7	8.0 (6)
Italy	10.1	13.5 (5)	6.7	26.0 (12)
Japan	15.6	4.0 (6)	14.2	12.0 (5)
Netherlands	14.7	4.0 (7)	9.2	.5 (4)
United Kingdom	13.7	15.5 (7)	11.9	12.5 (7)

TABLE II

Consistent Inflation & Required Money Growth Rates in EMS

Country	Consistent Inflation Rate	Actual Inflation Rate	Required Money Growth	Actual Money Growth
Belgium	8.1	4.5 (6)	5.7	5.4 (3)
Denmark	7.3	7.0 (4)	6.4	16.5 (2)
France	4.5	10.5 (7)	4.5	11.5 (2)
Germany	5.0	4.5 (7)	14.0	8.0 (6)
Italy	2.4	13.5 (5)	4.6	26.0 (12)
Netherlands	8.8	4.0 (7)	6.7	.5 (4)
United Kingdom	9.5	15.5 (7)	9.0	12.5 (7)

SOURCES OF BUDGET FINANCING
1970-1979

	(1)	(2)	(3)	(4)	(5)
1970	- 2,999	5,111	9,028	228	11,368
1971	-10,650	7,820	28,581	- 1,062	24,689
1972	6,209	1,454	7,648	2,504	17,815
1973	- 1,703	8,117	- 1,195	3,846	9,065
1974	3,291	6,988	1,884	- 1,796	10,367
1975	72,219	7,101	4,464	2,682	86,466
1976	49,569	6,462	7,023	- 916	62,138
1977	19,390	11,396	29,381	1,264	61,431
1978	22,337	14,283	29,025	-12,763	52,882

1978 MONTHLY

J	8,617	-11,054	3,716	3,612	4,891
F	1,894	7,750	1,752	- 3,111	8,285
M	- 1,180	2,848	7,649	6,972	16,289
A	- 609	- 275	- 2,991	- 2,174	- 6,049
M	2,119	4,726	- 1,932	- 2,165	2,748
J	- 2,122	- 1,631	- 522	- 4,126	- 8,401
Ju.	2,256	1,131	2,599	1,998	7,984
A	4,994	428	1,208	- 517	6,113
S	- 567	- 1,211	- 645	- 450	- 2,873
O	2,321	1,232	4,557	6,641	14,751
N	3,115	8,818	9,011	-16,440	4,504
D	1,499	1,521	4,623	- 3,003	4,640

1979 MONTHLY

	(1)	(2)	(3)	(4)	(5)
J	12,221	- 8,394	- 129	- 2	3,696
F	559	3,227	- 3,453	5,700	6,033
M	6,036	3,285	- 5,797	10,198	13,722
A	5,560	3,826	- 7,723	-11,497	- 9,834
M	12,432	- 958	- 8,067	1,415	4,822
J	-9259	- 2.4	2978	-4602	-11236

(1) NET CHANGE IN PRIVATELY HELD DEBT
(2) CHANGE IN NET SOURCE BASE
(3) CHANGE IN FOREIGN OFFICIAL ACCOUNTS
(4) CHANGE IN OTHER ACCOUNTS
(5) TOTAL FINANCING REQUIREMENTS

Table 1: Money Multiplier Components Forecasts and Actuals

RATIO	FORECAST ORIGIN	1979 JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEP	OCT	NOV	DEC	1980 JAN	FEB	MAR	APR	MAY	JUNE
K	ACTUAL	.363433	.383950	.386515	.373458	.389168	.382132	.380952											
	12/78	.362489	.380957	.383153	.373126	.388149	.384594	.383933	.390310	.388035	.386325	.392325	.388821						
	3/79				.376702	.392499	.389013	.388655	.395746	.393550	.392129	.398859	.395408	.387905	.409790	.412638			
	6/79							.380393	.387348	.383980	.381577	.388141	.383565	.375287	.396475	.397968	.385338	.402434	.396347
G	ACTUAL	.044403	.032652	.025480	.019813	.032495	.040541	.048727											
	12/78	.025206	.027559	.029074	.029796	.026096	.033048	.024574	.021250	.032142	.023781	.029754	.032769						
	3/79				.031721	.028915	.035775	.026601	.023004	.034794	.025743	.032209	.040344	.040147	.037069	.034155			
	6/79							.025206	.022575	.034274	.025359	.031728	.039742	.039548	.036516	.033645	.030876	.034755	.043751
TI	ACTUAL	1.918660	2.042093	2.056056	1.979439	2.062282	2.018769	2.004061											
	12/78	1.941783	2.060379	2.068726	2.000799	2.075798	2.040438	2.020231	2.061428	2.045556	2.035472	2.037919	1.990262						
	3/79				1.981650	2.057933	2.024657	1.997206	2.039918	2.025994	2.008564	2.012937	1.967594	1.970076	2.097778	2.108797			
	6/79							1.988016	2.032613	2.015522	1.996622	2.003020	1.954781	1.955718	2.084624	2.092235	2.007127	2.092816	2.050601
T2	ACTUAL	.377239	.391818	.382203	.346168	.343907	.316817	.310078											
	12/78	.369620	.378986	.383468	.380453	.387299	.387071	.387514	.388162	.389140	.387410	.392995	.392658						
	3/79				.375274	.380737	.375859	.374820	.374922	.374951	.372514	.377732	.377071	.378688	.381474	.376928			
	6/79							.300408	.295104	.288066	.282112	.284451	.282135	.282176	.283816	.279959	.271657	.269713	.262789
T3	ACTUAL	2.339925	2.482691	2.505684	2.407477	2.492457	2.441066	2.417866											
	12/78	2.340941	2.473117	2.490106	2.421528	2.506621	2.482415	2.473249	2.517102	2.510020	2.504657	2.510847	2.462977						
	3/79				2.436233	2.526400	2.504499	2.494796	2.543621	2.538995	2.533108	2.543958	2.497946	2.518255	2.672808	2.695578			
	6/79							2.419709	2.464387	2.447085	2.430211	2.437972	2.381401	2.389749	2.533662	2.541930	2.446570	2.536374	2.489038
R+L	ACTUAL	.052865	.049947	.049380	.049466	.049938	.049757	.050193											
	12/78	.053022	.050350	.049523	.049512	.050208	.049811	.050433	.049944	.049546	.050117	.049756	.049915						
	3/79				.049210	.049932	.049537	.050156	.049669	.049274	.049842	.049483	.049641	.0514908	.048763	.048175			
	6/79							.050302	.049837	.049440	.050010	.049650	.049809	.051664	.048927	.048338	.048336	.048831	.048628
B	ACTUAL	.001110	.001104	.001130	.001002	.001977	.001552	.001294											
	12/78	.000980	.000980	.000980	.000980	.000980	.000980	.000980	.000980	.000980	.000980	.000980	.000980						
	3/79				.001130	.001130	.001130	.001130	.001130	.001130	.001130	.001130	.001130	.001130	.001130	.001130			
	6/79							.001552	.001552	.001552	.001552	.001552	.001552	.001552	.001552	.001552	.001552	.001552	.001552

TABLE 2: SEASONALLY ADJUSTED M1 MONETARY BASE MULTIPLIER
MONEY STOCK COMPONENT DATA AS OF AUGUST 9, 1979

	1979												1980					
	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUNE
ACTUAL	2.51487	2.49637	2.49563	2.51407	2.50626	2.51513	2.51424											
Dec 78 Fcst	2.51596	2.49807	2.49858	2.49921	2.49358	2.48860	2.48667	2.48176	2.48171	2.47120	2.46503	2.45610						
Mar 78 Fcst				2.49914	2.49108	2.48638	2.48584	2.47887	2.47817	2.46888	2.46037	2.45078	2.45917	2.43701	2.43469			
June 78 Fcst							2.52549	2.51826	2.52316	2.51788	2.50908	2.50384	2.51586	2.49210	2.49355	2.50644	2.49676	2.49783

TABLE 3: SEASONALLY ADJUSTED M2 MONETARY BASE MULTIPLIER
MONEY STOCK COMPONENTS DATA AS OF AUGUST 9, 1979

	1979												1980					
	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUNE
ACTUAL	6.11406	6.10345	6.11735	6.13952	6.14295	6.16293	6.17058											
Dec 78 Fcst	6.16268	6.14779	6.15572	6.14302	6.13821	6.13021	6.12428	6.14266	6.13945	6.11940	6.12977	6.10270						
Mar 78 Fcst				6.19849	6.08960	6.08516	6.06860	6.08339	6.08148	6.05047	6.05650	6.03087	6.00771	5.98842	5.99201			
June 78 Fcst							6.17025	6.18882	6.19809	6.17659	6.18646	6.16907	6.15362	6.13523	6.14594	6.13965	6.13899	6.14037

TABLE 4: NOT SEASONALLY ADJUSTED M5 MONETARY BASE MULTIPLIER
MONEY STOCK COMPONENTS DATA AS OF AUGUST 9, 1979

	1979												1980					
	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUNE
ACTUAL	11.10396	11.30967	11.35397	11.33476	11.20148	11.20098	11.11964											
Dec 78 Fcst	11.15091	11.32898	11.38581	11.39437	11.28613	11.30140	11.24692	11.27813	11.31246	11.29369	11.22042	11.14258						
Mar 78 Fcst				11.35298	11.23955	11.25468	11.18815	11.21660	11.25240	11.22256	11.14593	11.07125	11.12179	11.28908	11.32574			
June 78 Fcst							11.12923	11.14788	11.17415	11.13818	11.05652	10.97694	11.02238	11.18615	11.21951	11.20583	11.08752	11.07719