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August 14, 1985

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee

By the staff of the Board of Governors of the Federal Reserve System

DOMESTIC NONFINANCIAL DEVELOPMENTS

Recent developments. Industrial production and payroll employment rose at a moderate rate in July while available indicators suggest that domestic final demands were growing more slowly than earlier in the year. Rates of wage and price increase remained at about their 1984 rates.

The index of industrial production increased 0.2 percent in July, similar to the average gain during the preceding two months. Rising output of consumer durables, including autos, more than offset some weakness in equipment production. Industrial capacity utilization changed little last month and is running about 1 percentage point below its longer-run average.

Nonfarm payroll employment expanded 1/4 million in July, but gains again were uneven across industries. Hiring in retail trade remained brisk, and increases at service establishments, although smaller than earlier in the recovery, were still sizable. Manufacturing employment edged down further, but declines were smaller than in earlier months. The losses in factory jobs since the beginning of the year have contributed to a reduction in the average monthly rise in total payroll employment from more than 300,000 in 1984 to 225,000 per month so far this year. In July, the civilian unemployment rate was 7.3 percent for the sixth consecutive month.

The slowing of employment gains has cut into the growth of personal income. And, although consumer survey responses were still quite positive through July, the pace of household spending appears to be moderating.

Auto sales dropped to a 10-1/2 million unit annual rate in June and July after averaging more than 11 million units over the preceding two months. The decline was entirely in purchases of domestic models, owing in part to the ending of financing incentive programs as well as competition from a more ample supply of Japanese models; sales of foreign cars have been robust since May. Retail sales of goods other than autos, gasoline, and nonconsumption items also have slowed on balance in recent months, posting a moderate 0.5 percent rise in July, after declining 1 percent in June.

Business spending developments in June were mixed. For equipment, shipments of nondefense capital goods by domestic producers rose 3-1/4 percent, offsetting the declines of the preceding two months. New orders for nondefense capital goods jumped 10-1/2 percent in June, but were still down 1 percent for the second quarter as a whole. At the same time, the market for nonresidential construction appears to be weakening. Outlays for these structures declined for a second consecutive month in June, with much of the recent weakness in industrial building. And, the value of building contracts and permits plunged in June after flattening out earlier this year.

The book value of manufacturing and trade inventories rose at a \$28 billion annual rate in June, but for the second quarter as a whole business inventory investment remained quite moderate. Manufacturers, who have been facing sluggish sales for the past year, held their book value inventories essentially unchanged during the first half of 1985. In addition, nonauto retailers, whose inventory-sales ratios have been relatively high, reduced their stocks in June. Auto stocks were up

slightly in June and rose further in July, as production remained firm despite weaker sales.

Lower mortgage interest rates have yet to stimulate an expected further pickup in housing activity. With new home sales in June just matching their improved first-quarter pace, and existing home sales only edging up, builders apparently have been cautious. Starts of new single-family units drifted down during the three months ending in June. At the same time, multifamily starts continued to be buoyed by strength in construction of rental apartments. Prospects for the multifamily sector, however, are dimming, as the average vacancy rate in this sector reached a 10-year high in the second quarter.

Changes in consumer and producer prices are still running at about their 1984 rates. The CPI rose 0.2 percent in June, and the PPI was up 0.3 percent in July after declining 0.2 percent in June. Goods prices are still rising very slowly, but consumers continue to face relatively high rates of increase in prices of services.

Wage inflation also appears to have leveled off this year, with the broad measures of hourly compensation rising at about a 4-1/4 percent annual rate over the first half. In addition to a continuation of moderate wage increases, particularly for unionized workers, the rise in the costs of fringe benefits apparently has slowed considerably. Unit labor costs, however, have accelerated from their cyclical low of the past two years, as production has slowed faster than hours worked thereby reducing output per hour.

Outlook. The staff's projections of economic activity and inflation for the next year and a half are essentially unchanged from the July

Greenbook. Real GNP is anticipated to grow at a 3 percent annual rate in the second half of 1985 and then to slow to a 2-1/2 percent rate during 1986. Inflation, as measured by the gross domestic business product fixed-weighted price index, is expected to be around 3-1/2 percent (annual rate) for the remainder of this year and then to accelerate somewhat next year to a 4 percent rate, as the dollar declines.

These projections incorporate some small changes in policy assumptions from those in July. For the second half of 1985, M1 is expected to be around the upper limit of the new range set by the FOMC at the mid-year meeting. Next year, growth of M1 again is assumed to be about 5-1/2 percent, the midpoint of the tentative 1986 range. No significant change in interest rates from current levels is expected through the end of the forecast horizon. For fiscal policy, the staff has incorporated into its estimates of outlays and receipts for fiscal year 1986 many elements of the recent Congressional budget resolution. The resulting deficit-reduction package now is assumed to be slightly smaller, at about \$45 billion, than in previous staff forecasts. The federal budget deficit, on a unified basis, which is expected to be around \$200 billion in fiscal year 1985, is projected to decline to about \$185 billion in fiscal year 1986.

As in the last Greenbook, domestic final demand, which had been growing much more rapidly than domestic production, is expected to moderate over the projection period. Consumer spending has been outstripping income growth by a considerable margin in recent quarters, and household indebtedness appears quite high. Thus, with income gains moderating, households are expected to slow the rise in their outlays, particularly

for durable goods, to a more sustainable rate over the next year and a half. Business demands for new equipment are projected to be fairly well maintained, as the incentive to invest in new technologies remains strong; however, outlays for structures are anticipated to be flat, held down by the end of the boom in office building. In the near term, outlays for residential construction are anticipated to contribute to some improvement in economic activity, as homebuilding responds to the lower level of mortgage interest rates. For nonfarm inventory investment, apart from the current quarter when some accumulation of stocks by auto dealers is projected to provide a boost to the overall growth rate of real GNP, businesses are expected to keep their stockbuilding in line with the rise in sales.

With respect to the external sector, the foreign exchange value of the dollar is assumed to trace a moderate downward path from its second-quarter level. With domestic demand growing less rapidly and the price advantage of foreign goods diminished, the rise in imports is projected to slow considerably. In addition, foreign demand for U.S. goods is expected to benefit from the lower dollar, providing some stimulus to domestic production by next year.

The decline in the dollar, however, also is projected to lead to some acceleration in prices during 1986, while other factors influencing inflation are expected to be largely neutral. The unemployment rate is likely to edge down only gradually over the forecast horizon, and industrial capacity utilization is expected to remain little changed at a level that should not generate increased inflationary pressures. Food prices are

anticipated to pick up a bit, as meat supplies tighten, but energy price increases should continue to be restrained by declining world oil prices.

Detailed data for these projections are in the tables shown on the following pages.

STAFF GNP PROJECTIONS

Percent changes, annual rate												
Nominal GNP		Real GNP		Gross domestic business product fixed-weighted price index				Unemployment rate (percent)				
				Total		Excluding food and energy						
7/3/85	8/14/85	7/3/85	8/14/85	7/3/85	8/14/85	7/3/85	8/14/85	7/3/85	8/14/85			
Annual changes:												
1983	<1>	7.7	7.7	3.7	3.7	3.7	3.7	4.6	4.6	9.6	9.6	
1984	<1>	10.8	10.8	6.8	6.8	4.0	4.0	4.3	4.3	7.5	7.5	
1985		6.2	6.1	2.5	2.4	3.7	3.6	4.3	4.2	7.2	7.3	
1986		6.2	6.2	2.7	2.6	3.7	3.7	4.1	4.1	7.1	7.1	
Quarterly changes:												
1984	Q1	<1>	14.9	14.9	10.1	10.1	4.2	4.2	3.4	3.4	7.9	7.9
	Q2	<1>	10.7	10.7	7.1	7.1	4.1	4.1	5.4	5.4	7.5	7.5
	Q3	<1>	5.6	5.6	1.6	1.6	4.0	4.0	4.9	4.9	7.4	7.4
	Q4	<1>	7.1	7.1	4.3	4.3	3.5	3.5	3.9	3.9	7.2	7.2
1985	Q1	<1>	5.6	5.6	.3	.3	3.6	3.6	4.6	4.6	7.3	7.3
	Q2	<1>	5.0	4.6	2.1	1.7	3.7	3.5	3.9	3.3	7.3	7.3
	Q3		6.4	5.9	3.5	3.0	3.2	3.3	3.8	3.9	7.2	7.3
	Q4		6.3	6.4	3.0	3.2	3.4	3.5	3.9	3.9	7.1	7.2
1986	Q1		6.4	6.3	2.7	2.5	3.7	3.8	4.0	4.1	7.1	7.1
	Q2		6.0	6.3	2.3	2.5	3.9	3.9	4.2	4.2	7.1	7.1
	Q3		6.2	6.2	2.3	2.4	4.1	4.1	4.4	4.4	7.1	7.1
	Q4		6.7	6.9	2.5	2.6	4.3	4.3	4.5	4.5	7.1	7.1
Two-quarter changes: <2>												
1984	Q2	<1>	12.8	12.8	8.6	8.6	4.2	4.2	4.4	4.4	-1.0	-1.0
	Q4	<1>	6.4	6.4	2.9	2.9	3.8	3.8	4.4	4.4	-.3	-.3
1985	Q2	<1>	5.3	5.1	1.2	1.0	3.7	3.5	4.3	4.0	.1	.1
	Q4		6.3	6.1	3.3	3.1	3.3	3.4	3.8	3.9	-.2	-.1
1986	Q2		6.2	6.3	2.5	2.5	3.8	3.8	4.1	4.1	.0	-.1
	Q4		6.5	6.5	2.4	2.5	4.2	4.2	4.4	4.5	.0	.0
Four-quarter changes: <3>												
1983	Q4	<1>	10.4	10.4	6.3	6.3	3.7	3.7	4.4	4.4	-2.1	-2.1
1984	Q4	<1>	9.5	9.5	5.7	5.7	4.0	4.0	4.4	4.4	-1.3	-1.3
1985	Q4		5.8	5.6	2.2	2.0	3.5	3.5	4.0	3.9	-.1	.0
1986	Q4		6.3	6.4	2.5	2.5	4.0	4.0	4.3	4.3	.0	-.1

<1> Actual.

<2> Percent change from two quarters earlier.

<3> Percent change from four quarters earlier.

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

	1983				1984			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3173.8	3267.0	3346.6	3431.7	3553.3	3644.7	3694.6	3758.7
Gross domestic purchases	3154.2	3273.4	3363.0	3461.5	3604.8	3703.4	3785.2	3814.8
Final sales	3216.8	3286.4	3350.9	3419.0	3479.5	3594.1	3622.8	3722.1
Private	2538.0	2604.2	2661.1	2727.6	2775.1	2850.4	2861.8	2941.6
Domestic final purchases	2518.4	2610.7	2677.5	2757.4	2826.6	2909.1	2952.4	2997.6
Personal consumption expenditures	2070.4	2141.6	2181.4	2230.2	2276.5	2332.7	2361.4	2396.5
Goods	1034.6	1073.0	1095.8	1122.8	1152.2	1179.0	1178.6	1192.8
Services	1035.8	1068.6	1085.7	1107.5	1124.4	1153.7	1182.8	1203.8
Gross private domestic investment	405.0	449.6	491.9	540.0	623.8	627.0	662.8	637.8
Residential structures	113.3	129.8	142.3	143.4	151.2	155.6	155.3	153.5
Business fixed investment	334.6	339.3	353.9	383.9	398.8	420.8	435.7	447.7
Change in business inventories	-42.9	-19.4	-4.3	12.7	73.8	50.6	71.8	36.6
Nonfarm	-32.6	-5.4	11.6	14.1	60.6	47.0	63.7	27.2
Net exports of goods and services <1>	19.6	-6.5	-16.4	-29.8	-51.5	-58.7	-90.6	-56.0
Exports	328.5	328.1	342.0	346.1	358.9	362.4	368.6	367.2
Imports	308.9	334.5	358.4	375.9	410.4	421.1	459.3	423.2
Gov't. purchases of goods and services	678.8	682.2	689.8	691.4	704.4	743.7	761.0	780.5
Federal <2>	273.0	270.5	269.2	266.3	267.6	296.4	302.0	315.7
State and local	405.8	411.6	420.6	425.1	436.8	447.4	458.9	464.8
Gross national product in constant (1972) dollars	1491.0	1524.8	1550.2	1572.7	1610.9	1638.8	1645.2	1662.4
Personal income	2662.8	2714.4	2763.3	2836.5	2920.5	2984.6	3047.3	3096.2
Wage and salary disbursements	1608.1	1642.1	1671.3	1715.4	1755.7	1793.1	1819.5	1847.6
Disposable personal income	2261.4	2302.9	2367.4	2428.6	2502.2	2554.3	2606.4	2644.5
Saving rate (percent)	5.7	4.2	5.0	5.3	6.1	5.7	6.3	6.2
Corporate profits with I.V.A. and C.C. Adj.	179.1	216.7	245.0	260.0	277.4	291.1	282.8	291.6
Corporate profits before tax	161.7	198.2	227.4	225.5	243.3	246.0	224.8	228.7
Federal government surplus or deficit (-) (N.I.A. basis)	-185.7	-167.3	-180.9	-180.5	-161.3	-163.7	-180.6	-197.8
High employment surplus or deficit (-) <3>	-80.9	-74.2	-102.5	-113.1	-113.3	-129.6	-146.1	-169.3
State and local government surplus or deficit(-) (N.I.A. basis)	34.1	43.9	47.4	51.2	53.9	54.5	47.6	55.6
Excluding social insurance funds	-1.9	7.0	9.5	12.0	13.4	12.6	4.3	11.1
Civilian labor force (millions)	110.7	111.2	112.1	112.1	112.7	113.5	113.8	114.2
Unemployment rate (percent)	10.4	10.1	9.3	8.5	7.9	7.5	7.4	7.2
Nonfarm payroll employment	88.8	89.6	90.5	91.8	93.0	94.0	94.9	95.8
Manufacturing	18.1	18.3	18.5	18.9	19.2	19.4	19.5	19.6
Industrial production (1977=100)	103.3	106.8	111.7	114.9	119.3	121.5	123.4	123.1
Capacity utilization: all manufacturing (percent)	70.2	72.5	75.8	77.4	79.8	80.8	81.6	81.0
Materials (percent)	71.4	73.6	77.0	79.3	82.0	82.6	83.0	81.4
Housing starts, private (million units, A.R.)	1.64	1.67	1.79	1.72	1.95	1.86	1.66	1.60
New auto sales (millions, A.R.)	8.46	9.10	9.22	9.94	10.52	10.60	10.30	10.29
Domestic models	6.06	6.81	6.92	7.29	8.22	8.23	7.94	7.50
Foreign models	2.40	2.28	2.31	2.65	2.30	2.38	2.36	2.79

- <1> Balance of payments data and details underlying these estimates are shown in the International Developments section of this part of the Greenbook.
> Components of purchases and total receipts and total expenditures are shown in the Federal Sector Account table which follows.
<3> Estimates in table are evaluated at a 6 percent high employment unemployment rate.

PERCENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Annual rates compounded quarterly)

	1983				1984			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	3.3	9.4	6.8	5.9	10.1	7.1	1.6	4.3
Gross domestic purchases	3.7	12.3	7.4	8.7	12.9	7.9	5.4	.9
Final sales	1.1	6.4	4.9	4.2	3.6	10.3	-1.0	7.9
Private	3.5	8.6	6.2	6.3	4.2	8.5	-2.4	8.4
Domestic final purchases	4.0	12.1	6.9	9.7	7.6	9.5	2.3	4.0
Personal consumption expenditures	2.6	10.0	3.8	6.8	4.6	7.9	.7	3.6
Goods	3.5	12.6	5.4	9.5	7.8	10.7	-1.9	3.8
Services	1.5	7.3	2.1	3.8	1.2	4.6	3.8	3.3
Gross private domestic investment	34.1	52.5	38.4	37.0	71.6	-2.2	24.9	-13.1
Residential structures	64.5	78.1	31.6	4.0	21.3	1.2	-4.6	-5.5
Business fixed investment	.0	9.6	18.7	30.6	20.6	21.3	13.7	8.5
Gov't. purchases of goods and services	-8.2	-2.6	-.5	-4.3	1.0	18.6	5.4	5.9
Federal	-17.4	-5.9	-5.3	-8.7	-2.8	45.2	6.2	15.2
National defense	6.8	7.6	-1.9	9.2	3.4	12.2	-2.3	17.5
State and local	-1.2	-.2	2.7	-1.4	3.5	3.7	4.8	-.2
Disposable personal income	2.1	3.3	7.7	8.2	8.6	6.3	3.9	3.5
<u>Current Dollars</u>								
Gross national product	8.5	12.3	10.1	10.6	14.9	10.7	5.6	7.1
Gross domestic purchases	6.7	16.0	11.4	12.2	17.6	11.4	9.1	3.2
Final sales	5.9	8.9	8.1	8.4	7.3	13.8	3.2	11.4
Personal consumption expenditures	4.8	14.5	7.6	9.2	8.6	10.2	5.0	6.1
Goods	3.6	15.7	8.8	10.2	10.9	9.6	-.1	4.9
Services	6.1	13.3	6.6	8.3	6.2	10.9	10.5	7.3
Gross private domestic investment	34.3	52.0	43.2	45.3	78.0	2.0	24.9	-14.3
Residential structures	79.3	71.9	44.4	3.3	23.6	12.1	-.6	-4.7
Business fixed investment	-5.5	5.7	18.5	38.4	16.5	23.9	14.9	11.5
Gov't. purchases of goods and services	-1.3	2.0	4.5	.9	7.8	24.3	9.6	10.7
Federal	-8.9	-3.6	-2.0	-4.3	2.0	50.5	7.8	19.4
National defense	7.9	9.8	3.3	13.2	12.5	14.7	-.8	22.1
State and local	4.2	5.8	9.0	4.4	11.5	10.0	10.7	5.2
Disposable personal income	4.3	7.5	11.7	10.7	12.7	8.6	8.4	6.0
Personal income	3.6	8.0	7.3	11.0	12.4	9.1	8.6	6.7
Wage and salary disbursements	5.6	8.7	7.3	11.0	9.7	8.8	5.9	6.5
Corporate profits with I.V.A. and C.C.M.T.	94.8	114.3	63.4	26.8	29.6	21.3	-10.9	13.0
Corporate profits before tax	16.0	125.7	73.3	-3.3	35.5	4.5	-30.3	7.1
Nonfarm payroll employment	.5	3.4	4.2	5.8	5.5	4.3	3.9	4.0
Manufacturing	-1.2	4.4	6.2	7.8	6.4	4.5	2.4	1.1
Nonfarm business sector								
Output per hour	4.4	8.1	2.1	1.0	2.9	5.5	-1.1	2.2
Compensation per hour	5.7	3.5	2.2	4.1	6.1	3.7	3.6	3.7
Unit labor costs	1.3	-4.2	.1	3.0	3.1	-1.7	4.7	1.4
GNP implicit deflator <1>	5.0	2.6	3.1	4.4	4.4	3.3	3.9	2.8
Gross domestic business product								
fixed-weighted price index <2>	2.7	3.9	4.5	3.5	4.2	4.1	4.0	3.5
Excluding food and energy	4.9	3.5	5.4	3.8	3.4	5.4	4.9	3.9
Consumer price index (all urban)	.4	4.3	4.2	4.2	5.2	3.7	3.7	3.6
Industrial production	11.5	14.0	19.8	12.0	16.0	7.6	6.4	-.7

<1> Excluding the federal pay increase, the rate of change in 1983-Q4 was 4.4 percent.
<2> Uses expenditures in 1972 as weights.

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

	1985				Projected 1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3810.6	3853.5	3908.9	3969.6	4030.9	4093.2	4155.5	4225.1
Gross domestic purchases	3885.2	3944.6	4009.8	4078.9	4143.8	4206.0	4269.8	4335.6
Final sales	3770.0	3840.9	3889.7	3944.2	4001.3	4061.1	4122.1	4191.1
Private	2978.1	3031.1	3063.1	3105.3	3150.8	3199.6	3249.1	3305.1
Domestic final purchases	3052.6	3122.2	3164.0	3214.6	3263.7	3312.4	3363.3	3415.6
Personal consumption expenditures	2446.5	2496.1	2526.5	2562.4	2599.9	2638.5	2678.8	2720.0
Goods	1212.1	1235.4	1241.4	1255.0	1269.3	1283.7	1298.6	1313.7
Services	1234.4	1260.7	1285.1	1307.4	1330.6	1354.8	1380.1	1406.2
Gross private domestic investment	646.8	638.7	656.7	677.6	693.4	706.0	717.9	729.6
Residential structures	155.2	159.6	165.6	174.7	179.7	182.4	185.7	189.3
Business fixed investment	450.9	466.5	471.9	477.5	484.1	491.5	498.8	506.3
Change in business inventories	40.7	12.6	19.2	25.4	29.6	32.1	33.4	34.0
Nonfarm	34.1	8.8	18.2	25.4	29.6	32.1	33.4	34.0
Net exports of goods and services <1>	-74.5	-91.1	-100.9	-109.2	-112.9	-112.9	-114.2	-110.5
Exports	360.7	349.5	354.6	357.7	362.1	372.0	381.6	395.6
Imports	435.2	440.7	455.5	466.9	475.0	484.9	495.8	506.1
Gov't. purchases of goods and services	791.9	809.8	826.6	838.9	850.5	861.5	873.1	886.0
Federal <2>	319.9	325.2	333.4	337.3	341.4	345.2	349.4	354.2
State and local	472.0	484.6	493.2	501.6	509.1	516.3	523.7	531.8
Gross national product in constant (1972) dollars	1663.5	1670.7	1683.2	1696.3	1706.9	1717.7	1727.7	1739.0
Personal income	3143.8	3181.6	3235.4	3293.8	3346.4	3399.0	3449.9	3506.1
Wage and salary disbursements	1882.7	1911.2	1938.0	1968.0	1997.8	2026.7	2055.0	2085.1
Disposable personal income	2654.8	2734.6	2757.0	2804.3	2857.5	2898.9	2939.2	2983.6
Saving rate (percent)	4.5	5.3	4.9	5.1	5.5	5.4	5.2	5.2
Corporate profits with I.V.A. and C.C. Adj.	292.3	290.3	287.5	286.9	286.4	290.0	293.1	299.3
Corporate profits before tax	222.3	213.8	207.4	206.3	205.8	208.9	211.0	215.7
Federal government surplus or deficit (-) (N.I.A. basis)	-165.1	-216.0	-198.2	-200.1	-203.8	-200.5	-196.9	-197.2
High employment surplus or deficit (-) <3>	-129.4	-179.7	-161.6	-164.8	-168.4	-164.3	-159.4	-159.6
State and local government surplus or deficit(-) (N.I.A. basis)	53.7	52.1	48.5	49.4	49.2	50.5	51.4	52.2
Excluding social insurance funds	8.3	6.0	1.5	1.6	.6	1.1	1.2	1.0
Civilian labor force (millions)	115.2	115.2	115.7	116.2	116.7	117.2	117.7	118.1
Unemployment rate (percent)	7.3	7.3	7.3	7.2	7.1	7.1	7.1	7.1
Nonfarm payroll employment	96.6	97.3	97.9	98.5	99.0	99.5	100.0	100.4
Manufacturing	19.6	19.4	19.5	19.5	19.6	19.6	19.7	19.7
Industrial production (1977=100)	123.8	124.4	125.1	126.0	126.9	127.7	128.5	129.3
Capacity utilization: all manufacturing (percent)	80.5	80.4	80.3	80.3	80.3	80.3	80.2	80.1
Materials (percent)	81.5	80.4	80.2	80.2	80.2	80.2	80.1	80.1
Housing starts, private (million units, A.R.)	1.80	1.77	1.85	1.90	1.90	1.85	1.85	1.85
New auto sales (millions, A.R.)	10.84	10.91	10.60	10.80	10.80	10.70	10.70	10.60
Domestic models	8.45	8.23	7.70	7.80	7.80	7.70	7.60	7.50
Foreign models	2.39	2.67	2.90	3.00	3.00	3.00	3.10	3.10

<1> Balance of payments data and details underlying these estimates are shown in the International Developments section of this part of the Greenbook.

<2> Components of purchases and total receipts and total expenditures are shown in the Federal Sector Account table which follows.

<3> Estimates in table are evaluated at a 6 percent high employment unemployment rate.

	1985				Projected 1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	.3	1.7	3.0	3.2	2.5	2.5	2.4	2.6
Gross domestic purchases	3.9	3.0	3.0	3.3	2.6	2.1	2.1	2.0
Final sales	-3	5.1	2.4	2.5	2.1	2.3	2.3	2.6
Private	-4	5.4	2.0	2.7	2.4	2.6	2.4	2.8
Domestic final purchases	4.1	6.9	1.9	2.9	2.5	2.1	2.1	2.0
Personal consumption expenditures	5.2	5.2	1.3	2.0	2.0	1.9	1.8	1.7
Goods	5.4	6.6	.1	2.0	1.9	1.7	1.5	1.5
Services	5.0	3.7	2.7	2.1	2.2	2.1	2.2	2.0
Gross private domestic investment	3.1	-5.8	8.1	9.9	6.2	4.0	3.3	3.0
Residential structures	5.3	14.3	12.9	19.3	7.9	2.2	3.2	3.7
Business fixed investment	-1.6	13.6	2.2	2.7	3.0	3.2	2.9	2.9
Gov't. purchases of goods and services	.3	3.9	4.3	1.8	1.2	1.3	1.7	2.1
Federal	.7	2.5	7.0	.8	.1	.7	1.6	2.3
National defense	-2	9.7	6.5	1.3	.8	1.2	2.5	3.3
State and local	.0	4.9	2.4	2.4	2.0	1.7	1.7	1.9
Disposable personal income	-1.6	9.3	-3	3.2	3.8	1.7	1.3	1.6
<u>Current Dollars</u>								
Gross national product	5.6	4.6	5.9	6.4	6.3	6.3	6.2	6.9
Gross domestic purchases	7.6	6.3	6.8	7.1	6.5	6.1	6.2	6.3
Final sales	5.2	7.7	5.2	5.7	5.9	6.1	6.1	6.9
Personal consumption expenditures	8.6	8.4	5.0	5.8	6.0	6.1	6.2	6.3
Goods	6.6	7.9	2.0	4.5	4.6	4.6	4.7	4.7
Services	10.6	8.8	8.0	7.1	7.3	7.5	7.7	7.8
Gross private domestic investment	5.8	-4.9	11.7	13.4	9.7	7.4	6.9	6.7
Residential structures	4.6	11.8	15.9	23.9	11.9	6.1	7.4	8.0
Business fixed investment	3.0	14.5	4.7	4.9	5.7	6.2	6.1	6.1
Gov't. purchases of goods and services	5.9	9.4	8.6	6.1	5.7	5.3	5.5	6.1
Federal	5.4	6.8	10.5	4.8	5.0	4.5	5.0	5.6
National defense	4.0	12.5	12.1	5.8	5.5	5.6	6.5	7.2
State and local	6.3	11.1	7.3	6.9	6.1	5.8	5.8	6.4
Disposable personal income	1.6	12.6	3.3	7.0	7.8	5.9	5.7	6.2
Personal income	6.3	4.9	6.9	7.4	6.5	6.4	6.1	6.7
Wage and salary disbursements	7.8	6.2	5.7	6.3	6.2	5.9	5.7	6.0
Corporate profits with I.V.A. and C.C.Adj.	1.0	-2.7	-3.9	-.8	-.7	5.1	4.4	8.7
Corporate profits before tax	-10.7	-14.4	-11.4	-2.1	-1.0	6.2	4.1	9.2
Nonfarm payroll employment	3.3	2.9	2.5	2.4	2.3	2.0	1.8	1.8
Manufacturing	.0	-2.7	.4	1.4	1.0	1.0	.8	.8
Nonfarm business sector								
Output per hour	-3.1	.5	1.2	1.5	.8	.9	1.0	1.2
Compensation per hour	5.0	3.4	3.9	4.2	4.7	4.3	4.4	4.5
Unit labor costs	8.4	2.9	2.7	2.7	3.9	3.4	3.4	3.3
GNP implicit deflator <1>	5.4	2.8	2.8	3.1	3.7	3.7	3.8	4.1
Gross domestic business product								
fixed-weighted price index <2>								
Excluding food and energy	3.6	3.5	3.3	3.5	3.8	3.9	4.1	4.3
Consumer price index (all urban)	4.6	3.3	3.9	3.9	4.1	4.2	4.4	4.5
Industrial production	3.2	4.2	3.3	3.6	4.0	4.1	4.3	4.5
Industrial production	2.1	2.0	2.3	3.0	2.8	2.6	2.5	2.6

<1> Excluding Federal pay increase, the rate of change in 1985-Q1 is 5.0 percent and in 1986-Q1 is 3.6 percent.
<2> Uses expenditures in 1972 as weights.

CONFIDENTIAL - FR
CLASS II FOMC

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

	1979	1980	1981	1982	1983	1984	—Projected—	
							1985	1986
Gross national product	2417.8	2631.7	2957.7	3069.2	3304.8	3662.8	3885.7	4126.2
Gross domestic purchases	2404.5	2607.7	2929.8	3050.2	3313.0	3727.0	3979.6	4238.8
Final sales	2403.5	2641.4	2931.7	3095.4	3318.3	3604.6	3861.2	4093.9
Private	1929.2	2103.7	2335.2	2444.9	2632.7	2857.2	3044.4	3226.1
Domestic final purchases	1915.9	2079.7	2307.2	2425.9	2641.0	2921.4	3138.3	3338.7
Personal consumption expenditures	1507.1	1668.0	1849.1	1984.9	2155.9	2341.8	2507.9	2659.3
Goods	813.4	883.5	966.1	1002.6	1081.5	1175.7	1236.0	1291.3
Services	693.7	784.5	883.0	982.2	1074.4	1166.1	1271.9	1367.9
Gross private domestic investment	423.0	401.9	484.2	414.9	471.6	637.8	654.9	711.7
Residential construction	118.5	102.9	104.3	91.3	132.2	153.9	163.8	184.3
Business fixed investment	290.2	308.8	353.9	349.6	352.9	425.7	466.7	495.2
Change in business inventories	14.3	-9.8	26.0	-26.1	-13.5	58.2	24.5	32.3
Nonfarm	8.6	-4.5	18.2	-23.9	-3.1	49.6	21.6	32.3
Net exports of goods and services <1>	13.2	23.9	28.0	19.0	-8.3	-64.2	-93.9	-112.6
Exports	281.3	338.8	369.9	348.4	336.2	364.3	355.6	377.8
Imports	268.1	314.8	341.9	329.4	344.4	428.5	449.6	490.5
Gov't. purchases of goods and services	474.4	537.8	596.5	650.5	685.5	747.4	816.8	867.8
Federal <2>	168.3	197.0	228.9	258.9	269.7	295.4	328.9	347.6
State and local	306.0	340.8	367.6	391.5	415.8	452.0	487.9	520.2
Gross national product in constant (1972) dollars	1479.4	1475.0	1512.1	1480.0	1534.7	1639.3	1678.4	1722.8
Personal income	1951.1	2165.3	2429.4	2584.6	2744.3	3012.1	3213.7	3425.3
Wage and salary disbursements	1237.6	1356.7	1493.1	1568.7	1659.2	1804.0	1925.0	2041.1
Disposable personal income	1650.2	1828.9	2041.7	2180.5	2340.1	2576.8	2737.7	2919.8
Saving rate (percent)	5.9	6.0	6.7	6.2	5.0	6.1	4.9	5.3
Corporate profits with I.V.A. and C.C.Adj.	194.8	175.4	190.0	159.2	225.2	285.7	289.2	292.2
Corporate profits before tax	252.7	234.6	221.3	165.6	203.2	235.7	212.4	210.3
Federal government surplus or deficit (-) (N.I.A. basis)	-16.1	-61.3	-64.2	-148.2	-178.6	-175.8	-194.9	-199.6
High employment surplus or deficit (-)	-20.8	-36.4	-31.3	-61.6	-92.7	-139.6	-158.9	-162.9
State and local government surplus or deficit (-) (N.I.A. basis)	30.6	30.6	37.6	32.9	44.1	52.9	50.9	50.8
Excluding social insurance funds	6.8	3.5	7.8	-8	6.6	10.4	4.3	1.0
Civilian labor force (millions)	105.0	106.9	108.7	110.2	111.6	113.5	115.5	117.4
Unemployment rate (percent)	5.8	7.1	7.6	9.7	9.6	7.5	7.3	7.1
Nonfarm payroll employment (millions)	89.8	90.4	91.2	89.6	90.2	94.5	97.6	99.7
Manufacturing	21.0	20.3	20.2	18.8	18.4	19.4	19.5	19.6
Industrial production (1977=100)	110.7	108.6	111.0	103.1	109.2	121.8	124.8	128.1
Capacity utilization: all manufacturing (percent)	84.6	79.3	78.3	70.3	74.0	80.8	80.4	80.2
Materials (percent)	87.1	81.1	81.1	71.7	75.3	82.3	80.6	80.2
Housing starts, private (million units, A.R.)	1.72	1.30	1.10	1.06	1.70	1.77	1.83	1.86
New auto sales (millions, A.R.)	10.68	9.04	8.56	8.00	9.18	10.39	10.79	10.70
Domestic models	8.36	6.62	6.24	5.77	6.77	7.95	8.05	7.65
Foreign models	2.32	2.42	2.32	2.23	2.41	2.44	2.74	3.05

<1> Balance of payments data underlying these estimates are shown in the International Developments section of this part of the Greenbook.

<2> Components of purchases and total receipts and total expenditures are shown in the Federal Sector Accounts table which follows.

August 14, 1985

CONFIDENTIAL - FR
CLASS II FOMCPERCENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1979	1980	1981	1982	1983	1984	Projected	
							1985	1986
<u>Constant (1972) Dollars</u>								
Gross national product	2.8	-.3	2.5	-2.1	3.7	6.8	2.4	2.6
Gross domestic purchases	2.0	-1.2	3.1	-1.2	4.9	8.7	3.4	2.6
Final sales	3.5	.5	1.5	-7	3.2	5.0	3.3	2.5
Private	4.0	.1	1.6	-1.3	4.1	5.3	3.0	2.6
Domestic final purchases	2.9	-1.0	2.2	-2	5.6	7.6	4.3	2.6
Personal consumption expenditures	2.7	.5	2.0	1.3	4.8	5.3	3.8	2.1
Goods	1.9	-1.4	1.7	.4	6.0	7.1	3.8	1.9
Services	3.7	2.7	2.3	2.5	3.4	3.2	3.8	2.3
Gross private domestic investment	-.2	-11.8	10.7	-15.9	13.7	31.2	1.2	5.3
Residential structures	-5.3	-20.3	-5.5	-14.8	41.7	12.2	5.0	8.9
Business fixed investment	7.3	-2.4	5.5	-4.6	2.5	19.8	7.0	3.5
Gov't. purchases of goods and services	1.3	2.2	.9	2.0	-.3	3.5	4.3	2.0
Federal	1.8	4.2	3.7	6.1	-.7	5.4	7.4	1.7
National defense	2.6	3.9	5.0	7.6	7.1	5.8	6.1	2.5
State and local	1.1	1.0	-.6	-.6	.0	2.2	2.1	2.2
Disposable personal income	2.7	.6	2.7	.9	3.5	6.7	3.0	2.7
<u>Current Dollars</u>								
Gross national product	11.7	8.8	12.4	3.8	7.7	10.8	6.1	6.2
Gross domestic purchases	11.1	8.5	12.3	4.1	8.6	12.5	6.8	6.5
Final sales	12.4	9.9	11.0	5.6	7.2	8.6	7.1	6.0
Personal consumption expenditures	11.9	10.7	10.9	7.3	8.6	8.6	7.1	6.0
Goods	11.7	8.6	9.3	3.8	7.9	8.7	5.1	4.5
Services	12.2	13.1	12.6	11.2	9.4	8.5	9.1	7.5
Gross private domestic investment	9.4	-5.0	20.5	-14.3	13.7	35.2	2.7	8.7
Residential structures	6.6	-13.2	1.3	-12.4	44.7	16.4	6.4	12.5
Business fixed investment	16.6	6.4	14.6	-1.2	.9	20.6	9.6	6.1
Gov't. purchases of goods and services	9.8	13.4	10.9	9.0	5.4	9.0	9.3	6.2
Federal	9.6	17.1	16.2	13.1	4.2	9.5	11.3	5.7
National defense	11.5	17.3	17.2	16.8	11.7	10.5	9.9	7.0
State and local	9.9	11.4	7.9	6.5	6.2	8.7	7.9	6.6
Disposable personal income	12.0	10.8	11.6	6.8	7.3	10.1	6.2	6.7
Personal income	12.6	11.0	12.2	6.4	6.2	9.8	6.7	6.6
Wage and salary disbursements	11.9	9.6	10.1	5.1	5.8	8.7	6.7	6.0
Corporate profits with I.V.A. and C.C.Adj.	1.2	-9.9	8.3	-16.2	41.5	26.9	1.2	1.0
Corporate profits before tax	10.3	-7.1	-5.7	-25.2	22.8	16.0	-9.9	-1.0
Nonfarm payroll employment	3.6	.6	.8	-1.7	.7	4.7	3.3	2.2
Manufacturing	2.6	-3.6	-.6	-6.9	-1.8	5.3	.4	.8
Nonfarm business sector								
Output per hour	-1.5	-.7	1.5	.2	3.5	2.7	.2	1.0
Compensation per hour	9.0	10.3	9.6	8.0	4.9	4.1	4.0	4.3
Unit labor costs	10.7	11.1	8.0	7.7	1.4	1.4	3.9	3.2
GNP implicit deflator	8.6	9.2	9.6	6.0	3.8	3.8	3.6	3.5
Gross domestic business product								
fixed-weighted price index <1>	9.9	9.9	9.7	5.9	3.7	4.0	3.6	3.7
Excluding food and energy	8.6	8.5	9.4	7.0	4.6	4.3	4.2	4.1
Consumer price index (all urban)	11.3	13.5	10.3	6.1	3.2	4.3	3.6	3.9
Industrial production	3.9	-1.9	2.2	-7.1	5.9	11.6	2.5	2.6

<1> Uses expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS
(Billions of dollars)

	Fiscal Year 1984*	FY1985 ^{2/}		FY1986 ^{2/}		CY1985 ^{2/}		FRB staff estimates							
		Congress 1/	FRB Staff	Congress 1/	FRB Staff	CY 1984*	FRB Staff	Calendar quarters; not seasonally adjusted							
								1984			1985				1986
								IV*	I*	II*	III	IV	I	II	III
Unified budget receipts	646	737	736	796	781	683	746	166	174	207	189	176	182	224	199
Unified budget outlays	842	935	936	963	968	868	941	239	230	234	233	244	240	241	242
Surplus/deficit(-), unified budget	-175	-199	-200	-167	-186	-184	-195	-72	-56	-27	-44	-68	-59	-17	-43
Surplus/deficit(-), off-budget agencies ³	-10	-11	-11	-5	-5	-10	-13	1	-3	-5	-5	-1	-1	-2	-1
Combined deficit to be financed	-185	-210	-211	-172	-191	-195	-209	-71	-59	-32	-49	-69	-59	-19	-44
Means of financing combined deficit:															
Net borrowing from public	171	n.a.	205	n.a.	184	199	201	64	42	45	54	60	50	32	42
Decrease in cash operating balance	7	n.a.	4	n.a.	2	-6	1	13	4	-10	-3	10	2	-10	0
Other ⁴	8	n.a.	2	n.a.	5	2	7	-6	13	-3	-2	-1	8	-3	2
Cash operating balance, end of period	30	n.a.	27	n.a.	25	18	17	18	14	24	27	17	15	25	25
Memo: Sponsored agency borrowing ⁵	30	n.a.	21	n.a.	20	32	23	3	4	8	6	5	5	5	5
NIA Budget															
								Seasonally adjusted annual rates							
Receipts	688	n.a.	746	n.a.	793	705	760	722	771	730	762	776	784	799	814
Expenditures	860	n.a.	941	n.a.	994	881	955	920	937	946	960	976	988	1000	1010
Purchases	283	n.a.	324	n.a.	343	295	329	316	320	325	333	337	341	345	349
Defense	215	n.a.	239	n.a.	257	222	244	232	234	241	248	251	255	258	262
Nondefense	68	n.a.	85	n.a.	87	74	85	84	86	84	86	86	87	87	87
All other expenditures	577	n.a.	617	n.a.	651	586	626	604	617	621	627	639	647	655	661
Surplus/deficit(-)	-172	n.a.	-194	n.a.	-200	-176	-195	-198	-165	-216	-198	-200	-204	-201	-197
High employment surplus/deficit(-) evaluated at 6 percent unemployment	-126	n.a.	-160	n.a.	-164	-140	-159	-169	-129	-180	-162	-165	-168	-164	-159

*--actual

e--estimated

n.a.--not available

1. Congressional Budget Resolution passed August 1, 1985; the unified and off-budget split is an F.R. staff estimate. Publication of the Administration's Mid-session Review budget estimates are anticipated around Labor Day.
2. The latest CBO budget estimates, which incorporate the Budget Resolution policy assumptions and the August 1985 CBO economic forecast, show revenues of \$737 billion and \$790 billion, combined unified and off-budget outlays of \$946 billion and \$965 billion, and total deficits of \$210 billion and \$175 billion in fiscal years 1985 and 1986, respectively.

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

3. Includes Federal Financing Bank, Postal Service Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank and Strategic Petroleum Reserve.
4. Checks issued less checks paid, accrued items and other transactions.
5. Sponsored agency borrowing includes net debt issuance by Federal Home Loan Banks, FHLMC (excluding participation certificates), FNMMA (excluding mortgage-backed securities), Federal Land Banks, Federal Intermediate Credit Banks, Banks for Cooperatives, and Student Loan Marketing Association marketable debt on a payment basis. The Administration's definition of borrowing by these agencies is somewhat broader.

DOMESTIC FINANCIAL DEVELOPMENTS

Recent developments. During the intermeeting period, federal funds have traded generally in the neighborhood of 7-3/4 percent--a bit higher than before midyear--and most other interest rates have risen about 20 to 40 basis points. The absence of further signs of easing in Federal Reserve policy, publication of some stronger-than-expected economic indicators, disappointment regarding federal budget prospects, and uncertainties about continued ready availability of foreign capital inflows have been factors tending to push interest rates upward.

Growth in all of the monetary aggregates slowed somewhat in July, but M1 and M2 still rose at a 9 percent annual rate--leaving M1 around the upper edge of the parallel band associated with its target for the second half of this year and M2 slightly above its 1985 target range. M1 growth was concentrated in its NOW account component. In M2, MMDAs and savings deposits also continued to grow rapidly but small time deposits declined as the spread between offering rates on these accounts and market rates widened, particularly for longer-term deposits. Relative rate movements also appear to have accounted for very slow growth of M2-type money market mutual funds and a substantial decline of M3-type funds. M3 grew only about 4-1/2 percent, as use of managed liabilities was sharply reduced, and this aggregate remained well inside its annual target range.

Total credit growth of nonfinancial sectors appears to have maintained the strong pace of earlier in this year, but some shifts have occurred in its composition. In the household sector, the expansion of consumer credit

slowed in June from the very rapid rate in previous months and partial data suggest that the more moderate June pace was maintained in July. Preliminary June data show a flattening of revolving credit, possibly reflecting repayment of credit card debt built up earlier when tax refunds were delayed. Residential mortgage debt growth evidently increased a little in the second quarter, but available data give no indication yet of a major response to second-quarter rate declines. In response to the rising level of mortgage delinquencies and foreclosures, FNMA recently followed in the footsteps of private insurers by announcing changes in standards for future mortgage purchases, which are intended to curb especially risky practices.

In the nonfinancial business sector, domestic bond issuance remained quite strong in July, although down from the extraordinary June pace which had been boosted by some very large corporate restructuring programs. Issuance abroad also remained strong; there was some shift to nondollar securities, with swaps arranged to avoid exposure to exchange rate risk. Some bond proceeds were used for paydowns of commercial paper and bank loans, which have been fairly flat in recent months. A good deal of borrowing was related to equity retirements through mergers and share repurchases, which remained important. Although new issuance was strong in July as stock market indexes reached new highs, net equity issuance was deeply negative.

In the government sectors, borrowing has continued heavy. State and local governments raised sizable amounts for advance refundings again in July; proceeds of some of these issues were parked in nonmarketable federal securities, which have been increasing rapidly. Federal marketable

borrowing also rose abruptly after midyear, partly reflecting the timing of settlement of issues auctioned at the end of the second quarter. Altogether, federal borrowing rose strongly and maintained the Treasury's cash balance at a fairly high level.

Outlook. Although the expansion in economic activity is expected to quicken somewhat in the second half, aggregate credit growth is likely to continue at about the pace observed in the year to date, without appreciable pressures on interest rates.

In the household sector, the slowing growth of spending for autos and other durable goods is expected to be associated with some further deceleration of consumer credit. Bank loan rates have come down a bit, but the end of auto manufacturer rate concession programs probably has offset any potential stimulus to credit use. Moreover, though consumers appear still to be quite willing to employ credit, the uptick in delinquency rates may suggest some incipient debt-capacity problems. In mortgage markets, where delinquency rates also have been rising, some tightening in nonrate terms is in process. Despite these changes, however, a pick-up in home mortgage borrowing is expected as housing activity increases, responding with a lag to the declines since spring in mortgage rates.

The gap between nonfinancial business sector investment outlays and internal funds will probably widen in the second half of the year as spending for inventories and fixed capital grows and after-tax profits flatten. Nevertheless, the size of the financing gap should remain moderate and total borrowing is not likely to accelerate significantly. The volume of equity retirements is assumed to slow further, reducing debt issuance for

this purpose. Short-term borrowing may well pick up from the recent sluggish pace, however, as the steep yield curve limits the desire of firms to lengthen their debt structure.

Although state and local government sector spending may increase a bit relative to tax receipts, borrowing by these units probably will diminish somewhat--on a seasonally adjusted basis--over the rest of this year. Total tax-exempt bond issuance could be boosted in coming months, however, by some step-up in private sector financing as borrowers attempt to make use of remaining annual quotas. Moreover, volume in the tax-exempt market will be sensitive to indications about tax reform legislation.

Federal sector debt growth will remain strong through the second half of the year, although its pace from quarter to quarter may be affected by delays in enactment of a new debt ceiling. The pickup in economic activity will be paralleled in tax collections and the newly passed budget resolution should result in some whittling down of outlay growth with the beginning of the new fiscal year. Nevertheless, these factors will make only a small dent in the deficit to be financed, as financial market participants have been quick to recognize.

Recent developments. Since the last FOMC meeting, the weighted average foreign exchange value of the dollar has depreciated 4 percent and is currently some 16 percent below its peak value reached in late February. Foreign short-term and long-term interest rates have continued to ease while dollar rates have risen. A realignment of the EMS currencies took place on July 20, after the Italian lira came under extreme downward pressure.

. Private foreign net purchases of U.S. Treasury securities during the second quarter exceeded \$5 billion, with Japanese investors accounting for a large share. On the other hand, net foreign purchases of U.S. corporate securities slowed somewhat in the second quarter.

In contrast to the securities and official accounts, both of which yielded net capital inflows during the second quarter, the banking sector--which had a strong domestic deposit growth--recorded a net outflow of nearly \$2 billion, reflecting a relatively large net outflow of \$5.4 billion in June. Available data for July indicate that this trend may have continued into the third quarter.

The U.S. merchandise trade deficit in the second quarter was the largest on record. The value of agricultural exports dropped 15 percent; the decline in nonagricultural exports was also substantial and spread fairly evenly across broad categories of export goods. Moreover, there were declines in nonagricultural exports to all major areas except Canada. The value of oil imports increased substantially from a relatively low first-quarter level. Nearly all of the rise was in volume, with the extra imported oil apparently going into inventories, which had been drawn down in the first quarter. The value of nonoil imports declined somewhat, primarily reflecting a decline of 8 percent in shipments from developing countries; imports from industrial countries increased marginally.

The pace of economic activity in several major foreign industrial economies appears to have increased in the second quarter. However, this acceleration largely represents a recovery from the distorted low or negative rates recorded in the first quarter and does not yet signal a move toward sustained higher rates of real growth. Despite the increased activity in several countries, unemployment rates have remained at or near record-high levels. Inflation rates in the major foreign industrial countries have shown no discernible trend in recent months.

Among the developing countries, Mexico has taken some corrective actions intended to return the country to the adjustment path from which it had deviated during the past nine months. The measures included a 16.7 percent devaluation of the controlled exchange rate to be followed by daily depreciations in amounts to be determined on a discretionary basis, a significant liberalization of import restrictions, and reductions in public sector spending.

In Argentina, the public appears to be accepting the country's new adjustment program and the wage-price freeze appears to be holding. However, certain key fiscal measures have not yet been implemented. Moreover, the liquidity of the Argentine financial system appears to be quite high, in part because of a rise in central bank reserves following the introduction of the new adjustment program. Under such circumstances, it is not clear how much longer the new program's wage-price freeze can hold.

The Brazilian government announced a series of measures aimed at narrowing its budget deficit. However, the measures are unlikely to provide the basis by themselves for a new agreement with the IMF.

Peru's new government has frozen nearly all prices, reduced interest rates, increased wages, and frozen dollar accounts in Peruvian banks for 90 days. A 10.7 percent devaluation was followed by an announcement that the exchange rate will remain indefinitely at the new rate. Peru's new president has said publicly that his country will pay no more than 10 percent of its export receipts in debt service during the next 12 months, and that priority in future repayments will be given to those creditors that grant new credits to Peru. The new administration also requested postponement of repayments of medium- and long-term public sector debts to foreign banks that fall due before January 31, 1986.

Outlook. The staff continues to project a moderate depreciation of the dollar throughout the forecast period. The projected level of the dollar in the fourth quarter of 1986 is somewhat lower than in the last Greenbook. The staff projection for economic activity in the foreign

industrial countries is essentially the same as in the last Greenbook, but somewhat slower growth is now expected in the developing countries. Based on recent data for merchandise trade and other transactions, small changes in the exchange rate projection, and the forecast for slower growth in developing countries, the staff has raised its projection of the current account deficit for 1985 to slightly more than \$130 billion, with a further increase to about \$150 billion projected for 1986.

AUGUST 13, 1985

OUTLOOK FOR U.S. NET EXPORTS AND RELATED ITEMS
(BILLIONS OF DOLLARS, SEASONALLY ADJUSTED ANNUAL RATES)

	ANNUAL			1984		1985				1986			
	1984-	1985-P	1986-P	Q3-	Q4-	Q1-	Q2-P	Q3-P	Q4-P	Q1-P	Q2-P	Q3-P	Q4-P
1. GNP EXPORTS AND IMPORTS 1/													
CURRENT \$, NET	-64.2	-93.9	-112.5	-90.6	-56.0	-74.5	-91.1	-100.8	-109.1	-112.8	-112.8	-114.1	-110.4
EXPORTS OF G+S	364.3	355.6	377.8	368.6	367.2	360.7	349.5	354.6	357.7	362.1	372.0	381.6	395.6
IMPORTS OF G+S	428.5	449.6	490.5	459.3	423.2	435.2	440.7	455.5	466.9	475.0	484.9	495.8	506.1
CONSTANT 72 \$, NET													
EXPORTS OF G+S	146.0	141.4	145.5	147.4	147.1	143.7	139.0	141.0	141.7	141.9	144.1	146.2	149.7
IMPORTS OF G+S	161.1	173.9	178.2	174.4	160.5	172.1	172.7	174.7	176.2	176.9	177.6	178.7	179.6
2. U.S. MERCHANDISE TRADE BALANCE 2/	-108.3	-137.7	-158.1	-130.0	-98.2	-118.2	-133.7	-146.0	-152.8	-155.8	-158.0	-159.9	-158.8
EXPORTS	220.3	215.8	227.8	222.1	225.4	222.8	211.6	213.3	215.6	218.7	224.0	230.1	238.4
AGRICULTURAL	38.4	29.8	29.9	36.9	38.3	33.5	28.4	28.2	29.1	29.3	29.9	30.0	30.3
NONAGRICULTURAL	181.9	186.0	197.9	185.3	187.2	189.3	183.2	185.1	186.5	189.4	194.1	200.1	208.2
IMPORTS	328.6	353.5	385.9	352.1	323.6	341.0	345.3	359.3	368.4	374.5	382.0	390.0	397.2
PETROLEUM AND PRODUCTS	57.5	50.3	47.3	57.8	56.8	45.2	52.8	53.2	50.2	47.4	46.7	47.6	47.4
NONPETROLEUM	271.1	303.2	338.7	294.4	266.9	295.8	292.5	306.1	318.2	327.1	335.3	342.4	349.9
3. U.S. CURRENT ACCOUNT BALANCE	-101.5	-132.5	-149.3	-130.0	-101.9	-120.5	-128.4	-134.7	-146.3	-148.2	-148.5	-150.4	-150.1
OF WHICH: NET INVESTMENT INCOME	19.1	20.1	21.8	13.0	16.0	10.5	20.2	25.9	23.8	22.6	22.3	21.5	20.7
4. FOREIGN OUTLOOK 3/													
REAL GNP--TEN INDUSTRIAL 4/	3.1	2.8	2.8	4.9	3.6	0.6	4.2	3.2	2.7	2.7	2.6	2.6	2.6
REAL GNP--NONOPEC LDC 5/	4.1	4.0	3.9	4.5	4.1	3.8	3.7	3.7	3.6	3.7	4.0	4.3	4.6
CONSUMER PRICES--TEN IND. 4/	4.9	4.5	3.9	2.6	4.8	5.4	5.7	2.9	3.6	4.3	4.3	3.3	3.7

1/ ECONOMIC ACTIVITY AND PRODUCT ACCOUNT DATA.

2/ INTERNATIONAL ACCOUNTS BASIS.

3/ PERCENT CHANGE, ANNUAL RATES.

4/ WEIGHTED BY MULTILATERAL TRADE-WEIGHTS OF G-10 COUNTRIES PLUS SWITZERLAND; PRICES ARE NOT SEASONALLY ADJUSTED.

5/ WEIGHTED BY SHARE IN NONOPEC LDC GNP.

P/ PROJECTED