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March 24, 1982

## **SUMMARY AND OUTLOOK**

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Prepared for the Federal Open Market Committee

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

## DOMESTIC NONFINANCIAL DEVELOPMENTS

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Summary. The rate of decline in economic activity has slowed in recent months; reductions in industrial production, payroll employment, and real retail sales were all more moderate between December and February than earlier. Moreover, inventories were liquidated at a rapid rate in December and January, paving the way for future production increases. On the inflation front, the news generally has been good, with both wages and prices showing substantial deceleration.

Industrial production rose 1.6 percent in February after falling 2.5 percent the month before, ending up 1 percent below last December. While at least half of February's rebound can be traced to better weather, the average decline in the first two months of 1982 is a substantial improvement over the large reductions in the last half of 1981.

Declines in employment also slowed in the first two months of this year. Nonfarm payroll employment, which dropped an average of 300,000 per month during the fourth quarter of 1981, fell at a third of that rate between December and February. The decline in employment continued to be concentrated in manufacturing, but the factory workweek, which had fallen precipitously in January, reversed its decline last month. The unemployment rate was the same in February as it had been in December: 8.8 percent.

Consumer spending has held up relatively well, given slow income growth and high interest costs. Retail sales fell 1.5 percent in January, but then rose 1.6 percent in February, leaving them 1/2 percent above their level in the fourth quarter of 1981 and down

slightly in real terms. Spending for new automobiles picked up, as domestic auto sales rose to a rate of 6-1/4 million units a year in February. However, this increase can be attributed to a wide-ranging program of rebates, rather than stronger underlying demand. In the first 10 days of March, domestic auto sales again dropped below 6 million units a year, despite the continuation of purchase incentives.

In the housing sector, activity has been edging upward since October, but still remains very depressed; starts rose to a 900,000 unit annual rate in January and then 950,000 in February. However, sales of both new and existing homes fell in January, when the weather was bad and mortgage rates were higher than a month earlier.

Business investment has continued to decline since the beginning of the year. Shipments of nondefense capital goods (in current dollars) were more than 2 percent below their fourth-quarter average in February. New orders have been lower than shipments since last August and the declining backlog of unfilled orders indicates that deliveries are likely to continue to fall. In contrast, surveys of plant and equipment spending suggest less deterioration than these indicators. The Commerce Department's January-February survey indicated that real outlays would be only one percent less in 1982 than in 1981, and a special McGraw-Hill survey conducted at about the same time indicated a real decline of 2-1/4 percent.

Inventory liquidation was proceeding at a rapid rate around the turn of the year. In constant dollar terms, manufacturing and trade inventories were reduced at a rate of \$24 billion a year from the end of November to the end of January. Liquidation of auto

inventories has been particularly large. On a seasonally adjusted basis, nearly a fifth of the stocks on hand at the end of December had been eliminated by the end of February, bringing them into better balance with current sales. The cutbacks in inventories, which were broadly based, should be setting the stage for production increases later this year.

Both the consumer and producer price indexes indicated further moderation of inflation in the first two months of 1982. Prices for finished goods at the wholesale level rose only 0.4 percent in January and then fell 0.1 percent in February; intermediate and crude material prices also declined in February. At the consumer level, prices rose 0.3 percent in January and 0.2 percent in February. Falling petroleum prices and rebates on new automobiles have been responsible for a substantial part of the recent price deceleration, but inflation in most other areas has been slowing as well.

The reductions in inflation over the past year, combined with rising unemployment and falling profits, have produced a marked decline in wage rate increases for production workers. Over the 12 months ended in February, the hourly earnings index rose 7-1/2 percent, compared with almost 10 percent a year earlier. The employment cost index (ECI) hints at some wage deceleration as well; over the last two quarters of 1981, the ECI for wages and salaries rose at an annual rate of 7-3/4 percent, compared with 8-3/4 percent for the comparable period in 1980.

Outlook. It now appears that the first-quarter decline in output will be about the same as in the fourth quarter. Although the

reduction in final sales apparently has ended, a substantial inventory liquidation is expected to result from the low level of production. Price increases for the first quarter are expected to be smaller than previously projected, reflecting lower inflation in food and energy.

With the inventory liquidation diminishing, real GNP is projected to post a small rise in the second quarter; the recovery in final sales is likely to be delayed until midyear when the second stage of the personal tax cut and a substantial increase in social security benefits will boost disposable income and add to consumer spending. The recent improvement in inflation is expected to extend into the second quarter, primarily in response to a further easing in energy prices.

Both the monetary policy assumptions and the budget estimates underlying the staff's projection have been changed. M1 growth is now assumed to be in the upper part of the Committee's range over four quarters of 1982, rather than at the midpoint; as earlier, it is assumed to decelerate during 1983. Interest rates are not expected to drop significantly below current levels, and thus remain very high in real terms.

On the fiscal side, the staff is continuing to assume that about half of the Administration's current deficit reduction program will be enacted. However, federal expenditures have been revised up by nearly \$20 billion (on a unified budget basis) for fiscal year 1983. This large increase stems from reestimates of program and debt service costs following the release of the Administration's budget proposals in

February. The resulting federal deficit (about \$160 billion in fiscal 1983) is expected to sustain pressures in financial markets.

Given these policy assumptions, the recovery in economic activity during the last half of 1982 is expected to fade early in 1983 and to revive only after the third round of personal tax cuts. The recovery in interest-sensitive sectors is expected to be particularly weak, with housing starts rising to only 1-1/4 million units a year by the end of 1983 and business fixed investment increasing at an annual rate of only 2 percent after its trough in the summer of this year. The external sector also is likely to limit real growth in 1982, as a strong dollar and slow income growth abroad are projected to reduce real net exports.

As was the case in the last Greenbook, defense purchases and consumer spending are expected to be the major sources of increased demand both this year and next. By the last half of 1983, personal consumption expenditures are expected to exceed 65 percent of GNP, while the defense share will rise to 6 percent of total output. Both of these fractions are substantially higher than their averages in the 1970s. In overall terms, the recovery is expected to be weaker than average; capacity utilization is expected to remain low and unemployment is projected to stay above 8-1/2 percent from now through 1983.

The recent reductions in inflation are projected to extend through next year. Reflecting continued weakness in aggregate demand and the energy price reductions early this year, the gross business product fixed-weighted price index is expected to rise only 6 percent during 1982. During 1983, the same price measure is projected to post

a rise of 5 percent. The price outlook should continue to benefit from an improved cost picture. Hourly compensation is projected to rise only 7-1/2 percent during 1982 and 6-1/2 percent during 1983, a substantial decline from 9-1/4 percent last year.



March 24, 1982

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STAFF GNP PROJECTIONS

Percent changes, annual rate											
		Gross domestic business product fixed-weighted price index						Unemployment rate (percent)			
Nominal GNP		Real GNP		Total		Excluding food and energy					
1/27/82	3/24/82	1/27/82	3/24/82	1/27/82	3/24/82	1/27/82	3/24/82	1/27/82	3/24/82		
<b>Annual changes:</b>											
1980	1/	8.8	8.8	-.2	-.2	9.8	9.8	8.2	8.2	7.1	7.1
1981	1/	11.3	11.4	1.9	2.0	9.4	9.4	9.0	9.2	7.6	7.6
1982		6.3	6.2	-.9	-.7	7.4	6.9	7.6	7.6	9.4	9.0
1983		8.3	8.4	2.6	3.1	5.7	5.4	5.4	5.2	9.2	8.8
<b>Quarterly changes:</b>											
1981-Q1	1/	19.2	19.2	8.6	8.6	10.5	10.5	8.4	8.4	7.4	7.4
1981-Q2	1/	4.7	4.7	-1.6	-1.6	8.2	8.2	9.7	9.7	7.4	7.4
1981-Q3	1/	11.4	11.4	1.4	1.4	9.9	9.9	11.5	11.5	7.2	7.4
1981-Q4	1/	2.7	4.6	-5.2	-4.5	7.1	7.5	7.7	8.2	8.4	8.3
1982-Q1		2.5	.2	-4.0	-4.5	6.9	6.2	6.4	6.7	9.3	8.8
1982-Q2		8.2	8.8	1.3	2.1	7.3	5.9	7.0	6.9	9.5	9.2
1982-Q3		10.9	10.9	4.5	5.1	6.8	6.0	6.5	6.1	9.4	9.1
1982-Q4		10.0	9.6	3.7	3.9	5.9	5.7	5.9	5.6	9.3	9.0
1983-Q1		7.0	7.0	1.4	1.9	5.5	5.4	5.1	4.9	9.3	8.9
1983-Q2		6.5	7.0	1.4	2.1	5.3	5.1	4.8	4.7	9.3	8.9
1983-Q3		8.7	8.9	3.9	4.5	5.1	4.6	4.5	4.4	9.2	8.7
1983-Q4		8.1	8.5	2.7	3.1	5.0	4.6	4.7	4.4	9.1	8.6
2/											
<b>Two-quarter changes:</b>											
1981-Q2	1/	11.7	11.7	3.4	3.4	9.2	9.2	9.0	9.0	-.1	-.1
1981-Q4	1/	7.0	7.9	-2.0	-1.6	8.5	8.7	9.6	9.8	1.0	.9
1982-Q2		5.3	4.4	-1.4	-1.3	7.1	6.0	6.7	6.8	1.1	.9
1982-Q4		10.5	10.3	4.1	4.5	6.3	5.9	6.2	5.8	-.2	-.2
1983-Q2		6.7	7.0	1.4	2.0	5.4	5.3	4.9	4.8	.0	-.1
1983-Q4		8.4	8.7	3.3	3.8	5.1	4.6	4.6	4.4	-.2	-.3
3/											
<b>Four-quarter changes:</b>											
1980-Q4	1/	9.4	9.4	-.3	-.3	9.7	9.7	8.6	8.6	1.6	1.5
1981-Q4	1/	9.3	9.8	.7	.9	8.9	9.0	9.3	9.4	.9	.8
1982-Q4		7.9	7.3	1.3	1.6	6.7	6.0	7.5	6.3	.9	.7
1983-Q4		7.6	7.8	2.3	2.9	5.2	5.0	5.3	4.6	-.2	-.4

1/ Actual.

2/ Percent change from two quarters earlier.

3/ Percent change from four quarters earlier.

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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.)

	1980				1981			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross national product	2571.7	2564.8	2637.3	2730.6	2853.0	2885.8	2965.0	2998.3
Final purchases	2569.1	2557.4	2653.4	2748.0	2848.5	2862.5	2937.6	2989.0
Private	2052.3	2027.4	2119.9	2189.4	2272.0	2285.1	2348.7	2367.0
Excluding net exports	2044.1	2010.3	2075.4	2166.1	2242.8	2264.3	2319.4	2342.3
Personal consumption expenditures	1631.0	1626.8	1682.2	1751.0	1810.1	1829.1	1883.9	1908.3
Goods	882.0	858.4	883.0	926.8	964.3	962.6	987.5	986.7
Services	749.0	768.4	799.2	824.2	845.8	866.5	896.4	921.5
Gross private domestic investment	415.6	390.9	377.1	397.7	437.1	458.6	463.0	443.3
Residential construction	115.2	93.6	99.2	113.0	116.7	110.7	100.5	94.2
Business fixed investment	297.8	289.8	294.0	302.1	315.9	324.6	335.1	339.8
Change in business inventories	2.5	7.4	-16.0	-17.4	4.5	23.3	27.5	9.4
Nonfarm	1.5	6.1	-12.3	-14.0	6.8	21.5	23.1	3.7
Net exports of goods and services <sup>1/</sup>	8.2	17.1	44.5	23.3	29.2	20.8	29.3	24.7
Exports	337.3	333.3	342.4	346.1	367.4	368.2	368.0	365.6
Imports	329.1	316.2	297.9	322.7	338.2	347.5	338.7	341.0
Gov't. purchases of goods and services	516.8	530.0	533.5	558.6	576.5	577.4	588.9	622.0
Federal <sup>2/</sup>	190.0	198.7	194.9	212.0	221.6	219.5	226.4	253.3
State and local	326.8	331.3	338.6	346.6	354.9	357.9	362.5	368.7
Gross national product in constant (1972) dollars	1501.9	1463.3	1471.9	1485.6	1516.4	1510.4	1515.8	1498.4
Personal income	2088.2	2114.5	2182.1	2256.2	2319.8	2368.5	2441.7	2486.5
Wage and salary disbursements	1314.7	1320.4	1341.8	1397.8	1442.9	1467.0	1498.5	1522.5
Disposable personal income	1765.1	1784.1	1840.6	1897.0	1947.8	1985.6	2042.0	2088.5
Saving rate (percent)	4.9	6.2	6.1	5.1	4.6	5.4	5.2	6.1
Corporate profits with I.V.A. and C.C. Adj	200.2	169.3	177.9	183.3	203.0	190.3	195.7	179.5
Corporate profits before tax	277.1	217.9	237.6	249.5	257.0	229.0	234.4	214.6
Federal government surplus or deficit (-) (N.I.A. basis)	-36.3	-66.5	-74.2	-67.9	-46.6	-47.2	-55.7	-99.5
High employment surplus or deficit (-) <sup>3/</sup>	-17.1	-21.5	-21.1	-13.4	.4	6.6	11.8	-25.1
State and local government surplus or deficit (-) (N.I.A. basis)	26.6	23.9	28.6	37.1	36.9	36.1	37.8	36.0
Excluding social insurance funds	1.3	-1.7	.9	8.1	6.6	4.3	5.1	2.3
Civilian labor force (millions)	106.5	106.8	107.2	107.5	108.1	108.8	108.7	109.2
Unemployment rate (percent)	6.3	7.3	7.6	7.5	7.4	7.4	7.4	8.3
Nonfarm payroll employment (millions)	90.8	90.5	90.2	90.8	91.2	91.5	91.9	91.5
Manufacturing	20.8	20.3	20.0	20.2	20.2	20.4	20.5	20.0
Industrial production (1967=100)	152.6	144.5	142.3	148.7	151.8	152.5	153.0	146.2
Capacity utilization: all mfg. (percent)	83.4	77.9	75.9	79.1	79.9	79.8	79.3	74.7
Materials (percent)	85.8	78.8	75.2	80.1	82.2	81.2	81.1	75.2
Housing starts, private (million units, A.R.)	1.25	1.06	1.39	1.50	1.40	1.17	.96	.87
New auto sales, (millions, A.R.)	10.65	7.68	8.80	9.04	9.96	7.89	9.04	7.37
Domestic models	7.87	5.53	6.51	6.57	7.31	5.63	6.90	5.13
Foreign models	2.77	2.14	2.29	2.47	2.66	2.25	2.14	2.24

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

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

<sup>3/</sup> Estimates in table are evaluated at a 5.1 percent high employment unemployment rate. Evaluated at a 6.1 percent unemployment rate, the high employment budget would show a deficit of \$37.8 billion in 1980-Q4 and a deficit of 51.7 billion in 1981-Q4.

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

	1980				1981			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) dollars</u>								
Gross national product	3.1	-9.9	2.4	3.8	8.6	-1.6	1.4	-4.5
Final purchases	3.1	-10.4	4.1	4.4	6.9	-4.7	.3	-1.8
Private	2.2	-13.3	6.5	4.9	7.3	-4.5	.8	-4.5
Excluding net exports	-4	-14.4	4.6	8.5	6.7	-3.1	1.9	-3.3
Personal consumption expenditures	.8	-9.8	5.1	7.0	5.8	-2.1	3.3	-2.2
Goods	-3	-17.7	4.0	10.2	9.8	-5.3	3.8	-5.5
Services	2.1	.0	6.4	3.7	1.4	1.6	2.6	1.7
Gross private domestic investment	-5.6	-28.9	-10.0	11.1	24.2	16.1	3.3	-24.7
Residential structures	-24.2	-60.2	16.0	64.2	3.6	-23.4	-36.2	-27.1
Business fixed investment	2.2	-19.9	-1.5	4.0	13.3	-2.1	6.9	-2.9
Gov't. purchases of goods and services	6.9	2.5	-5.0	2.2	5.4	-5.6	-1.5	10.2
Federal	18.9	11.9	-13.1	2.0	14.8	-8.4	3.1	28.2
National defense	9.8	6.2	-.1	5.9	1.1	2.6	7.9	16.3
State and local	.6	-2.8	.3	2.3	.2	-3.8	-4.2	.1
Disposable personal income	1.3	-4.9	4.1	2.9	3.0	1.4	2.6	1.6
<u>Current dollars</u>								
Gross national product	12.6	-1.1	11.8	14.9	19.2	4.7	11.4	4.6
Final purchases	12.0	-1.8	15.9	15.0	15.5	2.0	10.9	7.2
Private	10.7	-4.8	19.5	13.8	16.0	2.3	11.6	3.2
Excluding net exports	10.6	-6.5	13.6	18.7	14.9	3.9	10.1	4.0
Personal consumption expenditures	12.9	-1.0	14.3	17.4	14.2	4.3	12.5	5.3
Goods	13.1	-10.3	12.0	21.4	17.2	-.7	10.8	-.3
Services	12.7	10.8	17.0	13.1	10.9	10.1	14.6	11.7
Gross private domestic investment	5.6	-21.8	-13.3	23.7	45.9	21.1	3.9	-16.0
Residential structures	-16.7	-56.4	25.7	68.5	14.0	-19.2	-32.1	-22.9
Business fixed investment	11.0	-10.4	6.0	11.5	19.6	11.4	13.6	5.8
Gov't. purchases of goods and services	17.5	10.6	2.6	20.2	13.5	.6	8.2	24.5
Federal	29.5	19.8	-7.5	40.2	19.3	-3.7	13.1	56.7
National defense	23.2	12.4	8.4	35.0	10.4	8.7	16.9	47.0
State and local	11.2	5.6	9.1	9.7	10.0	3.3	5.3	7.1
Disposable personal income	13.5	4.4	13.3	12.8	11.2	8.0	11.8	9.4
Personal income	11.5	5.1	13.4	14.3	11.8	8.7	12.9	7.5
Wage and salary disbursements	10.5	1.8	6.6	17.8	13.5	6.9	8.9	6.6
Corporate profits with IVA & C.C. Adj.	24.8	-48.9	21.9	12.7	50.4	-22.8	11.8	-29.2
Corporate profits before tax	38.6	-61.8	41.4	21.6	12.6	-37.0	9.8	-29.7
Nonfarm payroll employment	1.5	-1.6	-1.0	2.7	1.8	1.4	1.7	-1.8
Manufacturing	-2.4	-9.7	-5.9	3.7	.5	4.2	2.4	-9.4
Nonfarm business sector								
Output per hour	.3	-2.9	3.6	-.2	4.4	1.4	-1.7	-6.8
Compensation per hour	10.3	11.3	9.0	9.8	11.7	9.6	9.5	6.2
Unit labor costs	9.9	14.6	5.3	10.1	7.0	8.1	11.5	14.0
GNP implicit deflator <sup>1/</sup>	9.3	9.8	9.2	10.7	9.8	6.4	9.9	9.5
Gross domestic business product								
fixed-weighted price index <sup>2/</sup>	10.1	9.8	9.6	9.3	10.5	8.2	9.9	7.5
Excluding food and energy	7.4	9.5	9.3	8.2	8.4	9.7	11.5	8.2
Consumer price index (all urban)	16.5	13.5	7.7	12.8	11.0	7.8	11.8	7.7
Industrial production	.3	-19.6	-6.2	19.2	8.3	1.9	1.3	-16.4

<sup>1/</sup> Excluding Federal pay increases, rates of change were: 1980-Q1, 9.2 percent; 1980-Q4, 9.7 percent; 1981-Q1, 9.7 percent; 1981-Q4, 7.4 percent.

<sup>2/</sup> Uses expenditures in 1972 as weights.

March 24, 1982

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

	Projected							
	1982				1983			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross national product	2999.7	3063.9	3143.9	3217.1	3271.7	3327.5	3399.4	3469.1
Final purchases	3029.7	3075.9	3140.9	3202.1	3256.7	3312.5	3384.4	3454.1
Private	2400.8	2444.1	2503.6	2548.4	2591.2	2635.0	2694.7	2748.3
Excluding net exports	2381.9	2421.8	2488.5	2547.7	2597.1	2644.6	2705.2	2756.9
Personal consumption expenditures	1951.4	1987.8	2042.3	2088.7	2128.4	2167.5	2218.3	2260.2
Goods	1001.4	1011.8	1041.6	1065.7	1084.4	1101.5	1130.3	1151.2
Services	950.0	976.0	1000.7	1023.0	1044.0	1066.0	1088.0	1109.0
Gross private domestic investment	400.5	422.0	449.2	474.0	483.7	492.1	501.9	511.7
Residential construction	93.2	98.2	106.2	113.2	117.2	119.7	123.2	127.2
Business fixed investment	337.3	335.8	340.0	345.8	351.5	357.4	363.7	369.5
Change in business inventories	-30.0	-12.0	3.0	15.0	15.0	15.0	15.0	15.0
Nonfarm	-30.0	-12.0	3.0	15.0	15.0	15.0	15.0	15.0
Net exports of goods and services <sup>1/</sup>	18.9	22.3	15.1	0.7	-5.9	-9.6	-10.5	-8.6
Exports	362.3	359.0	359.3	360.7	365.2	371.6	382.5	396.5
Imports	343.4	336.7	344.2	360.0	371.1	381.2	393.0	405.1
Gov't. purchases of goods and services	628.9	631.8	637.3	653.7	665.5	677.5	689.7	705.8
Federal <sup>2/</sup>	254.4	252.0	252.8	264.4	271.9	279.4	287.0	298.6
State and local	374.5	379.8	384.5	389.3	393.6	398.1	402.7	407.2
Gross national product in constant (1972) dollars	1481.1	1488.8	1507.6	1522.0	1529.0	1537.1	1554.1	1566.2
Personal income	2510.8	2560.9	2619.3	2677.1	2728.7	2780.2	2841.6	2896.8
Wage and salary disbursements	1536.0	1559.1	1588.6	1625.9	1653.7	1681.4	1713.4	1749.5
Disposable personal income	2113.1	2152.8	2232.1	2278.9	2330.7	2369.4	2446.9	2489.9
Saving rate (percent)	5.1	5.2	6.0	5.9	6.2	6.1	6.9	6.8
Corporate profits with I.V.A. and C.C. Adj.	151.0	165.8	187.5	195.6	194.9	198.4	212.1	219.6
Corporate profits before tax	177.7	188.3	205.5	208.6	202.6	199.8	207.1	206.4
Federal government surplus or deficit (-) (N.I.A. basis)	-116.9	-116.6	-147.6	-149.2	-158.2	-163.4	-201.4	-207.4
High employment surplus or deficit (-) <sup>3/</sup>	-21.8	-9.5	-45.8	-47.3	-52.5	-54.3	-98.0	-103.1
State and local government surplus or deficit (-) (N.I.A. basis)	36.1	40.5	44.8	43.4	43.3	44.5	48.2	50.7
Excluding social insurance funds	1.1	4.0	6.8	3.9	2.3	2.0	4.2	5.2
Civilian labor force (millions)	109.1	109.6	110.0	110.3	110.6	110.9	111.2	111.4
Unemployment rate (percent)	8.8	9.2	9.1	9.0	8.9	8.9	8.7	8.6
Nonfarm payroll employment (millions)	90.9	90.8	90.9	91.3	91.6	91.9	92.3	92.8
Manufacturing	19.5	19.4	19.5	19.7	19.9	20.0	20.2	20.4
Industrial production (1967=100)	141.1	143.1	147.8	151.1	151.8	152.7	155.3	157.1
Capacity utilization: all mfg. (percent)	71.3	71.8	73.9	75.1	75.0	74.9	75.7	76.1
Materials (percent)	71.3	72.4	75.6	77.4	77.4	77.6	79.0	79.7
Housing starts, private (million units, A.R.)	.94	1.05	1.15	1.20	1.20	1.20	1.25	1.25
New auto sales, (millions, A.R.)	8.30	7.90	9.10	9.30	9.40	9.40	9.80	9.80
Domestic models	6.00	5.50	6.60	6.80	6.90	6.90	7.20	7.20
Foreign models	2.30	2.40	2.50	2.50	2.50	2.50	2.60	2.60

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

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

<sup>3/</sup> Estimates in table are evaluated at a 5.1 percent high employment unemployment rate. Evaluated at a 6.1 percent unemployment rate, the high employment budget would show a deficit of \$74.8 billion in 1982-Q4, and a deficit of \$131.6 billion in 1983-Q4.

CONFIDENTIAL - FR  
CLASS II FOMC

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

	Projected							
	1982				1983			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) dollars</u>								
Gross national product	-4.5	2.1	5.1	3.9	1.9	2.1	4.5	3.1
Final purchases	.5	-.3	3.1	2.3	1.9	2.1	4.5	3.2
Private	.2	1.0	4.2	2.4	1.8	2.1	5.0	3.5
Excluding net exports	1.4	1.1	5.3	4.1	2.6	2.5	4.9	3.3
Personal consumption expenditures	3.5	2.0	5.5	3.8	2.5	2.5	5.2	3.3
Goods	2.9	1.0	7.9	5.0	2.4	2.1	7.4	3.9
Services	4.2	3.1	2.9	2.5	2.6	2.9	2.9	2.5
Gross private domestic investment	-38.3	17.1	21.8	18.3	3.0	2.2	3.2	3.2
Residential structures	-9.6	16.3	29.3	22.0	9.1	3.6	6.9	8.2
Business fixed investment	-7.7	-7.6	-1.3	1.1	1.5	1.9	2.3	1.9
Gov't. purchases of goods and services	1.9	-5.8	-1.7	1.6	2.0	2.3	2.4	1.7
Federal	7.2	-12.9	-2.8	5.1	6.7	7.0	6.7	4.9
National defense	2.0	3.0	5.9	7.6	12.5	12.3	12.9	9.1
State and local	-1.4	-.9	-.9	-.7	-1.0	-.7	-.5	-.4
Disposable personal income	-.8	2.0	9.4	3.1	4.0	1.8	9.1	2.7
<u>Current dollars</u>								
Gross national product	.2	8.8	10.9	9.6	7.0	7.0	8.9	8.5
Final purchases	5.6	6.2	8.7	8.0	7.0	7.0	9.0	8.5
Private	5.9	7.4	10.1	7.4	6.9	6.9	9.4	8.2
Excluding net exports	6.9	6.9	11.5	9.9	8.0	7.5	9.5	7.9
Personal consumption expenditures	9.4	7.7	11.4	9.4	7.8	7.6	9.7	7.8
Goods	6.1	4.2	12.3	9.6	7.2	6.5	10.9	7.6
Services	12.9	11.4	10.5	9.2	8.5	8.7	8.5	7.9
Gross private domestic investment	-33.4	23.3	28.4	24.0	8.4	7.1	8.2	8.0
Residential structures	-4.2	23.2	36.8	29.1	14.9	8.8	12.2	13.6
Business fixed investment	-2.9	-1.8	5.1	7.0	6.8	6.9	7.2	6.5
Gov't. purchases of goods and services	4.5	1.9	3.5	10.7	7.4	7.4	7.4	9.7
Federal	1.7	-3.7	1.3	19.7	11.8	11.5	11.3	17.2
National defense	6.8	6.9	10.4	23.7	18.0	17.4	18.0	22.2
State and local	6.4	5.8	5.0	5.1	4.5	4.7	4.7	4.5
Disposable personal income	4.8	7.7	15.6	8.6	9.4	6.8	13.7	7.2
Personal income	4.0	8.2	9.4	9.1	7.9	7.8	9.1	8.0
Wage and salary disbursements	3.6	6.2	7.8	9.7	7.0	6.9	7.8	8.7
Corporate profits with IVA & C.C. Adj.	-49.9	43.4	63.6	18.4	-1.4	7.4	30.6	14.9
Corporate profits before tax	-53.0	26.1	41.7	6.2	-11.0	-5.3	15.5	-1.5
Nonfarm payroll employment	-2.5	-.6	.7	1.6	1.4	1.2	1.9	1.8
Manufacturing	-9.9	-2.6	2.6	5.5	3.0	2.6	4.0	4.1
Nonfarm business sector								
Output per hour	-.1	3.1	4.9	2.5	.6	.8	2.4	1.1
Compensation per hour	8.4	7.4	7.3	6.9	7.1	6.4	6.4	6.2
Unit labor costs hour	8.5	4.2	2.3	4.3	6.5	5.6	3.9	5.0
GNP implicit deflator 1/	5.0	6.6	5.4	5.5	5.0	4.8	4.2	5.2
Gross domestic business product								
fixed-weighted price index 2/	6.2	5.9	6.0	5.7	5.4	5.1	4.6	4.6
Excluding food and energy	6.7	6.9	6.1	5.6	4.9	4.7	4.4	4.4
Consumer price index (all urban)	3.8	4.5	6.0	5.7	5.0	5.0	4.9	4.9
Industrial production	-13.2	5.8	13.8	9.2	1.9	2.4	7.0	4.7

1/ Excluding Federal pay increases, the rates of change are: 1982-Q1, 4.9 percent; 1982-Q4, 4.8 percent; 1983-Q1, 5.0 percent; 1983-Q4, 4.5 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.)

	1976	1977	1978	1979	1980	1981	-----Projected-----	
							1982	1983
Gross national product	1718.0	1918.0	2156.1	2413.9	2626.1	2925.5	3106.1	3366.9
Final purchases	1706.2	1897.0	2133.9	2396.4	2632.0	2909.4	3112.1	3351.9
Private	1344.1	1502.5	1701.3	1922.6	2097.3	2318.2	2474.2	2667.3
Excluding net exports	1330.4	1506.7	1701.9	1909.2	2074.0	2292.2	2460.0	2675.9
Personal consumption expenditures	1084.3	1205.5	1348.7	1510.9	1672.8	1857.8	2017.5	2193.6
Goods	598.5	657.8	729.1	814.5	887.6	975.2	1030.1	1116.8
Services	485.7	547.7	619.6	696.3	785.2	882.6	987.4	1076.7
Gross private domestic investment	257.9	322.3	375.3	415.8	395.3	450.5	436.4	497.3
Residential construction	72.0	95.8	111.3	118.6	105.3	105.5	102.7	121.8
Business fixed investment	174.1	205.5	242.0	279.7	296.0	328.9	339.7	360.5
Change in business inventories	11.8	21.0	22.2	17.5	-5.9	16.2	-6.0	15.0
Nonfarm	13.9	20.2	21.8	13.4	-4.7	13.8	-6.0	15.0
Net exports of goods and services <u>1/</u>	-13.7	-4.2	-.6	13.4	23.3	26.0	14.2	-8.7
Exports	170.9	183.3	219.8	281.3	339.8	367.3	360.3	378.9
Imports	157.1	187.5	220.4	267.9	316.5	341.3	346.1	387.6
Gov't. purchases of goods and services	362.1	394.5	432.6	473.8	534.7	591.2	637.9	684.6
Federal <u>2/</u>	129.2	143.9	153.4	167.9	198.9	230.2	255.9	284.2
State and local	232.9	250.6	279.2	305.9	335.8	361.0	382.0	400.4
Gross national product in constant (1972) dollars	1300.4	1371.7	1436.9	1483.0	1480.7	1510.3	1499.8	1546.6
Personal income	1391.2	1538.0	1721.8	1943.8	2160.2	2404.1	2592.0	2811.8
Wage and salary disbursements	889.9	983.8	1105.2	1236.1	1343.7	1482.7	1577.4	1699.5
Disposable personal income	1194.4	1311.5	1462.9	1641.7	1821.7	2016.0	2194.2	2409.2
Saving rate (percent)	6.9	5.6	5.2	5.2	5.6	5.3	5.6	6.5
Corporate profits with I.V.A. and C.C. Adj.	138.1	164.7	185.5	196.8	182.7	192.1	175.0	206.2
Corporate profits before tax	166.3	192.6	223.3	255.4	245.5	233.7	195.0	204.0
Federal government surplus or deficit (N.I.A. basis)	-53.1	-46.4	-29.2	-14.8	-61.2	-62.3	-132.6	-182.6
High employment surplus or deficit (-)	-20.1	-23.1	-15.7	-2.2	-18.3	-1.6	-31.1	-77.0
State and local government surplus or deficit (-) (N.I.A. basis)	16.6	28.1	29.0	26.7	29.1	36.7	41.2	46.7
Excluding social insurance funds	.9	10.1	9.0	2.9	2.1	4.6	3.9	3.4
Civilian labor force (millions)	96.2	99.0	102.3	105.0	106.9	108.7	109.8	111.0
Unemployment rate (percent)	7.7	7.1	6.1	5.8	7.1	7.6	9.0	8.8
Nonfarm payroll employment (millions)	79.4	82.5	85.7	89.8	90.6	91.5	91.0	92.2
Manufacturing	19.0	19.7	20.5	21.0	20.3	20.3	19.5	20.1
Industrial production (1967=100)	130.5	138.1	146.1	152.5	147.1	151.0	145.8	154.2
Capacity utilization: all manufacturing (percent)	79.5	81.9	84.4	85.6	79.1	78.4	73.0	75.4
Materials (percent)	81.1	82.7	85.6	87.4	80.0	79.9	74.2	78.4
Housing starts, private (million units, A.R.)	1.54	1.99	2.02	1.75	1.29	1.09	1.08	1.22
New auto sales, (millions, A.R.)	10.12	11.13	11.28	10.70	9.04	8.56	8.65	9.60
Domestic models	8.63	9.07	9.29	8.38	6.62	6.24	6.22	7.05
Foreign models	1.50	2.06	1.99	2.32	2.42	2.32	2.42	2.55

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

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

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CLASS II FOMC

PERCENT CHANGES IN GROSS NATIONAL PRODUCT  
AND RELATED ITEMS

	1976	1977	1978	1979	1980	1981	--Projected--	
							1982	1983
<u>Constant (1972) dollars</u>								
Gross national product	5.4	5.5	4.8	3.2	-.2	2.0	-7	3.1
Final purchases	4.2	5.2	4.7	3.5	.7	1.3	.0	2.4
Private	5.3	6.0	15.4	4.0	.2	1.5	-.1	2.7
Excluding net exports	6.2	6.5	5.2	2.9	-1.0	2.2	.9	3.4
Personal consumption expenditures	5.6	4.9	4.7	2.9	.5	2.5	2.0	3.5
Goods	6.7	5.2	4.2	1.9	-1.4	2.5	1.2	4.1
Services	4.3	4.5	5.4	4.1	2.6	2.6	2.9	2.8
Gross private domestic investment	19.2	15.7	7.6	1.3	-12.5	5.5	-9.0	8.6
Residential structures	21.3	18.6	2.9	-5.2	-18.6	-6.1	-8.5	12.6
Business fixed investment	5.2	11.9	9.1	6.5	-3.0	2.5	-3.4	.7
Gov't. purchases of goods and services	.0	2.1	2.0	1.5	2.9	.6	.5	1.0
Federal	-.7	4.1	-.9	1.9	6.3	3.1	3.7	3.8
National defense	-2.3	.8	.0	2.6	5.7	4.2	6.4	9.9
State and local	.5	.9	3.7	1.2	1.0	-.9	-1.4	-.8
Disposable personal income	3.6	3.6	4.4	3.1	.7	2.2	2.3	4.5
<u>Current dollars</u>								
Gross national product	10.9	11.6	12.4	12.0	8.8	11.4	6.2	8.4
Final purchases	9.6	11.2	12.5	12.3	9.8	10.5	7.0	7.7
Private	10.5	11.8	13.2	13.0	9.1	10.5	6.7	7.8
Excluding net exports	11.8	13.3	12.9	12.2	8.6	10.5	7.3	8.8
Personal consumption expenditures	11.1	11.2	11.9	12.0	10.7	11.1	8.6	8.7
Goods	10.9	9.9	10.8	11.7	9.0	9.9	5.6	8.4
Services	11.2	12.7	13.1	12.4	12.8	12.4	11.9	9.0
Gross private domestic investment	25.1	25.0	16.5	10.8	-4.9	14.0	-3.1	14.0
Residential structures	30.2	33.1	16.1	6.6	-11.3	.2	-2.7	18.6
Business fixed investment	10.3	18.1	17.7	15.6	5.8	11.1	3.3	6.1
Gov't. purchases of goods and services	6.5	8.9	9.7	9.5	12.9	10.6	7.9	7.3
Federal	5.3	11.4	6.6	9.5	18.5	15.7	11.2	11.1
National defense	3.7	8.5	7.1	11.2	18.4	17.2	16.2	17.5
State and local	7.3	7.6	11.4	9.6	9.8	7.5	5.8	4.8
Disposable personal income	9.0	9.8	11.5	12.2	11.0	10.7	8.8	9.8
Personal income	10.0	10.6	12.0	12.9	11.1	11.3	7.8	8.5
Wage and salary disbursements	10.4	10.6	12.3	11.8	8.7	10.3	6.4	7.7
Corporate profits with IVA & C.C. Adj.	25.0	19.3	12.6	6.1	-7.2	5.1	-8.9	17.8
Corporate profits before tax	25.9	15.8	15.9	14.4	-3.9	-4.8	-16.6	4.6
Nonfarm payroll employment	3.2	3.9	5.1	3.6	.8	1.1	-.6	1.3
Manufacturing	3.7	3.6	4.2	2.6	-3.5	-.2	-3.7	3.2
Nonfarm business sector								
Output per hour	3.2	2.0	-.2	-.7	-.3	.9	-.1	1.9
Compensation per hour	8.1	7.6	8.5	9.7	9.9	10.1	7.8	6.8
Unit labor costs	4.7	5.5	8.7	10.4	10.3	9.0	7.9	4.8
GNP implicit deflator	5.2	5.8	7.3	8.5	9.0	9.2	6.9	5.1
Gross domestic business product								
fixed-weighted price index <sup>1/</sup>	5.5	6.3	7.8	9.7	9.8	9.4	6.9	5.4
Excluding food and energy	6.0	6.5	7.5	8.4	8.2	9.2	7.6	5.2
Consumer price index (all urban)	5.8	6.5	7.7	11.3	13.5	10.3	6.3	5.2
Industrial production	10.8	5.8	5.8	4.4	-3.5	2.7	-3.4	5.8

<sup>1/</sup> Uses expenditures in 1972 weights.

FEDERAL SECTOR ACCOUNTS  
(billions of dollars)

	Fiscal Year 1981*	FY1982 <sup>e</sup>		FY1983 <sup>e</sup>		CY 1981*	CY1982 F.R. Board	FRB Staff Estimates								
		Admin. 1/	F.R. Board	Admin. 1/	F.R. Board			Calendar quarters; unadjusted data								
								1981		1982				1983		
								III*	IV*	I	II	III	IV	I	II	III
Unified budget receipts <sup>2/</sup>	599.3	626.8	621.9	666.1	633.0	619.0	618.3	155.8	146.0	141.9	183.9	150.1	142.4	146.0	188.7	155.9
Unified budget outlays <sup>2/</sup>	657.2	725.3	733.3	757.6	791.0	691.6	734.1	164.3	194.2	164.0	186.5	188.6	195.0	194.2	196.2	205.6
Surplus/deficit(-), unified budget	-57.9	-98.6	-111.4	-91.5	-158.0	-72.5	-115.8	-8.6	-48.2	-22.1	-2.6	-38.5	-52.6	-48.2	-7.5	-49.7
Surplus/deficit(-), off-budget agencies <sup>3/</sup>	-21.0	-19.7	-17.5	-15.7	-18.5	-22.4	-17.9	-6.9	-3.6	-3.9	-4.8	-5.3	-3.9	-5.0	-4.7	-4.9
Combined deficit to be financed	-78.9	-118.3	-128.9	-107.2	-176.5	-94.9	-133.7	-15.5	-51.8	-26.0	-7.4	-43.8	-56.5	-53.2	-12.2	-54.6
Means of financing combined deficit:																
Net borrowing from public	79.4	115.4	122.8	108.0	179.1	87.3	141.3	18.5	35.6	30.6	12.6	44.0	54.1	49.9	19.4	55.7
Decrease in cash operating balance	2.3		3.3		0.0	0.3	-0.4	-2.3	6.7	0.5	-3.5	-0.4	3.0	2.2	-4.9	-0.3
Other <sup>4/</sup>	-2.8	{ 2.9	2.9	{ -0.8	-2.6	7.3	-7.2	-0.7	9.5	-5.1	-1.7	0.2	-0.6	1.1	-2.3	-0.8
Cash operating balance, end of period	18.7	n.a.	15.4	n.a.	15.4	12.0	12.4	18.7	12.0	11.5	15.0	15.4	12.4	10.2	15.1	15.4
Memo: Sponsored agency borrowing <sup>5/</sup>	32.9	46.6	18.1	50.1	26.8	30.0	21.8	15.4	3.6	1.9	6.5	6.1	7.3	6.5	6.5	6.5
<b>NIA Budget</b>								Seasonally adjusted annual rates								
Receipts	613.0	641.0	626.3	685.7	644.1	626.1	627.4	638.3	627.7	621.4	635.2	620.7	632.3	643.5	656.3	644.3
Expenditures	667.9	741.4	746.4	787.6	812.1	688.4	760.0	694.0	727.2	738.2	751.8	768.3	781.5	801.7	819.7	845.7
Purchases	218.3	249.0	253.1	272.9	275.7	230.2	255.9	226.4	253.3	254.4	252.0	252.8	264.4	271.9	279.4	287.0
Defense	147.1	174.1	174.3	203.2	201.9	154.3	179.3	154.1	169.7	172.5	175.4	179.8	189.6	197.6	205.7	214.4
Nondefense	71.2	74.9	78.8	69.7	73.8	75.9	76.6	72.2	83.5	81.9	76.6	73.0	74.8	74.3	73.7	72.6
All other expenditures	449.6	492.4	493.3	514.7	536.4	458.2	504.1	467.6	473.9	483.8	499.8	515.5	517.1	529.8	540.3	558.7
Surplus/deficit(-)	-54.9	-100.4	-120.1	-101.9	-168.1	-62.3	-132.6	-55.7	-99.5	-116.8	-116.6	-147.6	-149.2	-158.2	-163.5	-201.4
High Employment (H.E.) surplus/deficit(-) evaluated at H.E. unemployment rate of:																
5.1 percent	1.4	n.a.	-25.6	n.a.	-63.0	-1.6	-31.1	11.8	-25.1	-21.8	-9.5	-45.8	-47.3	-52.5	-54.3	-98.0
6.1 percent	-25.2	n.a.	-52.6	n.a.	-91.1	-28.7	-58.4	-18.8	-51.7	-48.7	-37.3	-72.7	-74.8	-80.7	-83.0	-126.0
	*actual					e--estimated								n.a.--not available		

1. The Budget of the United States Government, Fiscal Year 1983, February 1982.

2. Outlays and receipts have been reduced by about \$4.0 billion due to the reclassification of supplemental medical insurance premiums (SMI) from receipts to an offset to outlays.

3. Includes Federal Financing Bank, Postal Service Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank and (beginning in FY1982) the Strategic Petroleum Reserve.

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

5. FRB staff estimates include Federal Home Loan Banks, FNMA, Federal Land Banks, Marketing Administration marketable debt on an offerings basis. FRB and Administration estimates are not strictly comparable.

NOTE: Quarterly figures may not add to yearly totals due to rounding.



## DOMESTIC FINANCIAL DEVELOPMENTS

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Summary. The surge in M1 that began late last year ended in February, when this aggregate contracted at a 3-3/4 percent annual rate. Data through mid-March, moreover, suggest only a slight increase this month. The broader measures of the money stock slowed appreciably in February but showed signs of picking up in early March.

Most market interest rates have dropped 50 to 110 basis points over the intermeeting period. Nevertheless, intermediate- and long-term rates remain high as worries about a conflict between monetary restraint and prospective large federal deficits persist.

Even with weakness in February and early March, M1 in the first quarter will expand on a quarterly average basis at about a 10 percent annual rate, the most rapid pace since late 1980. The surge in M1 was considerably faster than would have been expected on the basis of historical relationships among narrow money, GNP and interest rates. That surge was concentrated in the OCD component and may in part have reflected heightened liquidity preference associated with increased uncertainty about interest rates and the economy.

Sluggish M2 growth in February, at a 4 percent annual rate, reflected a deceleration in its nontransactions component as well as the drop in M1. Weakness in nontransactions M2 was concentrated in its more liquid components as small declines in savings deposits and overnight RPs and Eurodollars, coupled with reduced inflows to broker/dealer and general purpose MMMFs, offset a pickup in the growth of small denomination time deposits.

The slowdown in growth of M3 in February--to a 5-1/2 percent annual rate--was less marked than that of the narrower measures. Large time

deposit issuance picked up and term RPs resumed expanding while lagging yields on MMMFs led to more rapid run-offs of institution-only MMMFs than in January. More rapid growth of large time deposits at commercial banks in February reflected much smaller core deposit inflows and continued strong growth of bank credit. The expansion in bank credit, at an 11-1/2 percent annual rate after adjusting for shifts of assets to international banking facilities, was led by rapid loan expansion. In early March, however, total loans and investments at large banks showed evidence of slowing appreciably.

With conditions in long-term markets generally unfavorable, businesses in the first quarter have concentrated their reduced borrowing demands in the short-term area. In January and February the bulk of short-term borrowing was from domestic offices of large U.S. banks, as the spread of the prime rate over open market rates narrowed. Following an easing of long-term rates, bond issuance in early March rose from depressed January and February levels while reduced short-term borrowing was directed more toward the commercial paper market and offshore branches, as open market rates fell relative to the prime rate.

The Treasury has continued to place heavy demands on credit markets in the first quarter, raising about \$31 billion. This is off moderately from the fourth quarter of last year and is well below earlier expectations as receipts have been stronger, and expenditures weaker, than had been anticipated by the Treasury. State and local governments have continued to borrow heavily in long-term markets in the first quarter, mostly in the form of revenue issues.

By contrast, household borrowing in recent months has been very sluggish. In the mortgage market--where reliance on "creative" financing and adjustable rate loans has increased--borrowing apparently has strengthened only a bit in the first quarter from the depressed levels of late 1981. Outstanding consumer installment credit increased only slightly in January and likely declined in February.

With interest rates remaining high and economic activity weak, evidence of financial strain continues to mount. Downgradings of corporate debt--affecting firms in a variety of industries, including some of the largest corporations and banking organizations--have risen and further actions to cut dividends have been taken. Similarly, several downgradings of state and local general obligation debt have been announced. Bankers surveyed recently indicated a growing deterioration in the quality of their business, consumer, and mortgage loan portfolios.

Outlook. In the coming months, money market rates may ease a bit, even though economic activity is expected to strengthen, as the highly unusual buildup in narrow money balances that occurred around the turn of the year continues to unwind. Accompanying declines in short-term rates, long-term rates may edge downward, especially if inflation news continues to be favorable.

Aggregate credit flows are expected to expand in the months ahead, especially after midyear. In the second quarter, the Treasury is expected to run a small deficit, in contrast to typically large surpluses at that time of year, and tap the markets for about \$15 billion. Borrowing by the Treasury will then balloon in the third quarter to finance a projected combined deficit of \$45 billion. State and local government borrowing, too,

is expected to remain substantial in light of underlying fiscal positions; any significant rally in the tax-exempt market is likely to elicit a considerable pick-up in bond issuance.

Borrowing by the household sector is expected to remain light by comparison to the late 1970s, but some expansion should accompany the projected upturn in the economy. However, suppliers of mortgage and consumer credit may remain cautious in their lending policies, reflecting uncertainties about default risk and their profitability.

The overall volume of funds raised by businesses is expected to rise a bit in the next few months as growth in capital expenditures, reflecting reduced inventory liquidation, is likely to outpace improvements in cash flow. Unless long-term rates decline appreciably, borrowing may well remain concentrated in short-term markets--with further erosion occurring in corporate balance sheets. The outlook is one involving clear risk in the perceived creditworthiness of many firms; firms experiencing downgradings of securities might have to rely still more heavily on commercial bank credit lines, adding to concerns about the quality of bank loan portfolios.

## INTERNATIONAL DEVELOPMENTS

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Summary. The weighted average value of the dollar has moved up strongly since the last FOMC meeting, reversing course only briefly when U.S. short-term interest rates dipped in late February and early March. Over the period the dollar's weighted average value rose by three percent, almost back to its 1981 peak.

On average, foreign short-term interest rates have declined steadily since January, with some acceleration in recent weeks. Several major foreign countries have acted to reduce interest rates, including the United Kingdom, Switzerland, Belgium, Sweden, Germany, and the Netherlands. On the other hand, rates have risen in Canada over the past two months, and France recently moved to reverse the decline in interest rates to resist pressure on the franc.

There has been considerable turbulence in relationships among foreign currencies in the past several weeks. On February 21 a realignment of currency values in the European Monetary System (EMS) was announced, with the central rates of the Belgium and Luxembourg francs lowered by 8-1/2 percent, and the rate of the Danish crown was reduced by 3 percent. That realignment provided only temporary respite for the Belgian franc, and significant downward pressure has also been exerted on the French franc and the Italian lira.

. . . The Japanese yen has also been under continuous downward pressure,

. Finally, the Mexican peso dropped by about 40 percent after the Mexican government announced a temporary withdrawal of support for the peso in February.

Widespread reductions in interest rates abroad seem to reflect heightened concern with weak economic performance -- the average growth rate of GNP in major countries was under 1 percent in the first three quarters and close to zero in the fourth quarter of last year. In addition, some countries are seeing improvements in their current accounts and gradual reductions in inflation rates. Policy makers abroad appear to be shifting their focus more to relative interest and exchange rates among themselves and somewhat less to their situation vis-a-vis dollar rates.

The U.S. balance on current account registered a small deficit in the final quarter of 1981 after small surpluses in earlier quarters. The merchandise trade deficit rose in the fourth quarter while the positive balance on other current transactions was unchanged. In January the trade deficit was above the fourth-quarter rate, with both agricultural and other exports declining slightly while the volume of petroleum imports rose quite sharply (though these monthly data fluctuate widely) at generally unchanged prices. Non-oil imports were at about the fourth-quarter rate in January.

Data on private capital flows for the full year 1981 show a moderate increase in bank-reported net outflows -- with an especially large net outflow in the fourth quarter. Part of the outflow was reversed in January.

Net capital flows related to direct investments registered an extraordinary swing from a minus \$8 billion in 1980 to a plus \$12 billion in 1981. Major elements in the 1981 inflow were large acquisitions of U.S. companies by foreign investors, and borrowings abroad by U.S. companies via their offshore financial affiliates. The borrowings rose sharply to about \$3 billion in the first quarter of this year.

Data covering banks' positions with their own foreign offices show a net inflow of about \$5 billion in January-February. Lending to U.S. nonbanks by foreign branches of U.S. banks rose only slightly from December to early March.

The rate of lending to foreigners by U.S. banks (combining U.S. and foreign offices) eased off somewhat in the second half of 1981 from the \$60 billion annual rate of the first half. The decline in the rate of lending affected mainly major industrial countries and offshore banking centers; lending to other areas -- smaller industrial countries, OPEC, and the developing countries -- was greater than the rate in 1980 or the first half of 1981.

Outlook. Given the weaker than expected outcome for economic activity abroad in the closing months of last year, and the absence of any indication of a pickup so far this year, projections for 1982 have been scaled down somewhat since the last Greenbook. However, a recovery is projected, with growth rates reaching 2 percent annually for major industrial countries in the last half of 1982, rising to about 2-1/2 percent in 1983. This projection is based in part on a gradual reduction of interest rates abroad, leading to some revival of consumer and

investment demand. Nevertheless, at the projected rates of growth unemployment is likely to rise further over the period ahead.

With demand abroad remaining weak, and the average exchange value of the dollar at a higher level than assumed in earlier projections, the U.S. current account deficit is now expected to rise considerably by the end of this year and into 1983. For 1982 the deficit will average about \$11 billion, compared with a \$7 billion surplus in 1981, and in 1982 it is projected to average \$35 billion. A few positive elements in the new projection -- a somewhat lower price for petroleum imports, and lower domestic inflation rates -- are more than offset by the factors mentioned above, as well as by some reduction in the value of agricultural exports and lower exports to Mexico after the peso devaluation.

The average exchange value of the dollar is now well above earlier expectations, with the adverse effects on the current balance noted above. However, it is expected that as the size of the U.S. deficit on current account becomes evident upward pressure on the dollar will reverse, bringing its value back to around its 1981 average by the end of the projection period.



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

	1981 ANN.	1982 <sup>P</sup> ANN.	1983 <sup>P</sup> ANN.	1982 <sup>P</sup> Q I	1982 <sup>P</sup> Q II	1982 <sup>P</sup> Q III	1982 <sup>P</sup> Q IV	1983 <sup>P</sup> Q I	1983 <sup>P</sup> Q II	1983 <sup>P</sup> Q III	1983 <sup>P</sup> Q IV
<b>1. GNP NET EXPORTS</b>											
CURRENT \$, NET	26.0	14.2	-8.7	18.9	22.2	15.1	.6	-6.0	-9.6	-10.5	-8.7
EXPORTS OF G&S	367.3	360.3	378.9	362.3	359.0	359.3	360.7	365.2	371.6	382.5	396.5
IMPORTS OF G&S	341.4	346.1	387.6	343.4	336.7	344.2	360.0	371.1	381.2	393.0	405.1
CONSTANT 72 \$, NET	44.9	33.2	26.2	35.7	35.7	33.0	28.4	26.3	25.4	26.1	27.0
EXPORTS OF G&S	160.4	152.0	150.9	154.6	152.6	151.2	149.5	148.8	149.1	151.4	154.5
IMPORTS OF G&S	115.5	118.8	124.7	118.9	116.9	118.2	121.1	122.5	123.7	125.3	127.5
TERMS OF TRADE (1972=100) 1/	77.5	81.4	80.8	81.1	81.7	81.6	81.2	81.0	80.9	80.6	80.8
<b>2. U.S. MERCHANDISE TRADE BALANCE 2/</b>											
EXPORTS (EXCL. MILITARY)	236.3	220.7	227.4	226.1	221.0	218.1	217.5	220.3	224.3	228.5	236.3
AGRICULTURAL	44.3	42.9	48.2	42.1	42.0	42.8	44.8	47.1	48.5	47.8	49.3
NONAGRICULTURAL	192.0	177.8	179.2	184.0	179.0	175.3	172.7	173.2	175.8	180.6	187.0
IMPORTS	264.1	259.8	292.0	260.1	251.1	257.0	271.1	280.2	287.0	296.3	304.5
PETROLEUM AND PRODUCTS	77.6	65.5	71.1	65.6	64.2	64.5	67.9	68.8	69.9	72.3	73.2
NONPETROLEUM	186.5	194.3	220.9	194.5	186.9	192.5	203.2	211.3	217.1	224.0	231.3
<b>3. U.S. CURRENT ACCOUNT BALANCE</b>											
OF WHICH: NET INVESTMENT INCOME	6.6	-11.0	-35.6	-5.9	-2.8	-10.2	-25.1	-31.9	-35.6	-37.4	-37.6
	36.8	31.1	32.5	31.0	29.9	31.6	31.8	31.1	30.2	33.9	34.6
<b>4. FOREIGN OUTLOOK - TEN INDUSTRIAL COUNTRIES 3/</b>											
REAL GNP, % CHANGE, ANNUAL RATES	.4	1.1	2.5	1.2	1.5	2.0	2.3	2.6	2.6	2.9	3.2
CONSUMER PRICES, 4/, % CHANGE, ANNUAL RATES	9.7	8.7	7.8	8.7	8.9	8.2	7.9	7.8	7.6	7.2	7.1

1/ GNP EXPORT IMPLICIT DEFLATOR DIVIDED BY GNP IMPORT IMPLICIT DEFLATOR.

2/ INTERNATIONAL ACCOUNTS BASIS.

3/ GEOMETRIC WEIGHTS USED TO AGGREGATE FOREIGN REAL GNP AND CONSUMER PRICES -- PERCENT SHARE IN TEN-COUNTRY TOTAL MULTILATERAL TRADE. CANADA (9.1%), JAPAN (13.6%), UNITED KINGDOM (11.9%), GERMANY (20.8%), FRANCE (13.1%), ITALY (9.0%), BELGIUM (6.4%), THE NETHERLANDS (8.3%), SWITZERLAND (3.6%), SWEDEN (4.2%).

P/ PROJECTED.