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February 6, 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. Domestic output strengthened at year-end, reflecting the substantial progress businesses made adjusting inventories and a drop back in imports after the third-quarter surge. Moreover, consumer demand firmed, and business spending remained relatively vigorous. The environment for further growth remained positive, especially as inflation continued moderate.

Industrial production rose 1 percent over the November-December period, and preliminary indications suggest an additional 1/2 percent gain in January. The advance in December was broadly based. Output of consumer goods rose 0.6 percent, and production of business equipment was up 0.7 percent. Automobile assemblies rebounded sharply from their strike-affected levels of the early fall and are estimated to have risen further in January to an 8-3/4 million unit annual rate. Industrial capacity utilization moved up to 81.9 percent in December, but it remained almost a point below its recent high reached in mid-1984.

Labor demand has strengthened in the past several months. Nonfarm payroll employment (strike-adjusted) was up a substantial 300,000 in January, about the same as average increases during the fourth quarter. The bulk of the payroll growth in January was in service-producing industries, while manufacturing payrolls rose a more moderate 23,000. Nevertheless, the household survey reported a rise in unemployment in January, with the civilian jobless rate increasing 0.2 percentage point to 7.4 percent.

Personal income rose briskly in the final quarter of 1984, paced by sizable advances in wages and salaries. With continued income gains, real

personal consumption expenditures rose by 4 percent at an annual rate last quarter. Outlays for discretionary items such as general merchandise, apparel, and furniture and appliances were particularly strong. Sales of domestic autos averaged an 8.3 million unit annual rate during December and January; this pace was a million units above that of the preceding two months when short supplies had constrained sales of some popular models.

Business fixed investment rose 11 percent in real terms in the fourth quarter--a bit slower than the rate of growth in the third quarter. The fourth-quarter gain reflected a sizable rise in shipments of nondefense capital goods as well as a rapid advance in spending for commercial and industrial buildings. However, new orders for nondefense capital goods at domestic producers fell in December. Although the December drop reflected an unusually steep--and likely temporary--decline in the office and computing machinery component, new orders generally were sluggish throughout the second half of 1984.

Inventory accumulation by businesses slowed significantly late in the year. Stocks at all manufacturing and trade establishments were little changed in November, after rising sharply in each of the preceding four months. Manufacturers' inventories declined in real terms in November for the first time in 10 months, and preliminary book-value data indicate another decline probably occurred in December. At the retail level, strong sales in November as well as aggressive Christmas marketing and price discounting helped to correct imbalances that emerged in late summer and early fall.

Housing markets, as yet, have shown little response to the decline in mortgage credit costs since last summer. While single-family starts were

up a bit in the final quarter of the year, multifamily starts fell sharply. Overbuilding in some key markets and uncertainty regarding future tax treatment of investment properties probably discouraged new construction of rental units.

The rate of inflation has continued to reflect moderate labor costs, low-priced imports, and reduced energy prices, with the consumer price index up only 0.2 percent in both November and December. These increases brought consumer prices at the end of 1984 to a level 4 percent above a year earlier—little different from the increase in 1983. Food and energy developments continued favorable during the past year. Moreover, prices of consumer goods excluding food and energy advanced only 3 percent in 1984. Prices of consumer services, in contrast, rose 5-1/2 percent last year, reflecting notable increases in rents, auto finance charges, and the price of telephone service. The producer price index for finished goods was up 0.1 percent in December and rose only 1.8 percent during the 12 months of 1984.

Wage inflation in the private nonfarm economy moderated further in 1984, with the employment cost index decelerating from a 5 percent increase in 1983 to 4 percent last year. Wage adjustments under union wage contracts signed last year, excluding COLAs, will average 2.4 percent in the first contract year and 2.3 percent annually over the contract life; both of these figures were new lows for the 17-year history of the series. Reflecting the slower rise in productivity last year, unit labor costs rose about 2 percent, after remaining unchanged in 1983.

Outlook. The staff is projecting an increase of close to 4 percent in real GNP in the current quarter, and all major components of private

domestic spending are expected to contribute to the rise. Continued gains in employment and income are anticipated to support a further increase in consumer expenditures; moreover, business investment spending--while decelerating somewhat--is expected to post a sizable advance. At the same time, residential construction is projected to edge up after two successive quarters of decline. Inventory investment also is likely to pick up early in 1985, as businesses respond to rising sales. However, in the external sector exports are expected to be lower, and imports are expected to rebound. The fixed-weighted price index for gross domestic business product is projected to rise 3-3/4 percent at an annual rate during the current quarter.

The policy assumptions underlying the staff projection for 1985 are little changed from the last Greenbook. Regarding monetary policy, M1 growth is assumed to be in the upper part of the Committee's tentative range this year and to moderate a bit next year. Interest rates are expected to be unchanged or rising somewhat during 1985. For fiscal policy, the staff estimates that the federal budget deficit in the current fiscal year will be \$206 billion on a unified basis.¹ For 1986 the staff has assumed enactment of a deficit reduction package on the order of \$50 billion, primarily reflecting reductions in outlays from current service levels. As a result, the federal deficit in FY 1986 is projected to drop to around \$189 billion.

After two years of vigorous expansion, economic activity is expected to grow moderately during 1985 and 1986. Real GNP is projected to rise about

1. The Budget Document now emphasizes the combined unified and off-budget deficits, estimated at \$222 billion in FY 1985 and \$180 billion in FY 1986. The corresponding staff estimates of the combined deficits are \$218 billion and \$194 billion, respectively.

3-1/2 percent this year and 2-3/4 percent next year. The ongoing expansion in capital spending is expected to continue during 1985, with real investment projected to rise 7 percent. The increase in business investment is expected to slow a bit over the course of 1986. Continued gains in real disposable income should support further, sizable advances in consumption this year. Thereafter, household spending is expected to slow somewhat, as employment and income gains moderate. Housing starts during this year and next are projected to average about the 1.75 million unit pace recorded in 1984. With businesses remaining relatively cautious regarding inventories, the staff anticipates no substantial change from current, historically low inventory-sales ratios. The anticipated decline in the foreign exchange value of the dollar is expected to contribute to an increase in export demand and a considerable slowing in imports by 1986.

Economic growth in both this year and next should be accommodated without any undue pressure on capacity in either product or labor markets. Unemployment is expected to decline to the 6-3/4 percent range during the course of 1985, as continued gains in employment outstrip labor force growth. In 1986 the jobless rate is expected to be little changed. On the production side, industrial capacity utilization is projected to rise a bit this year and then to flatten out.

The outlook for inflation in 1985 has improved from the last Greenbook, with the fixed-weighted index for gross business product now expected to rise only 3-3/4 percent. Lower world oil prices have favorable implications for the domestic rate of inflation in the near term. Moreover, with the dollar now higher and with the onset of its expected depreciation delayed, the adverse effects of such an adjustment on domestic prices this year are

projected to be small. The price outlook for 1986 is for only a limited acceleration in inflation, mainly driven by the projected depreciation of the dollar. Increases in unit labor costs are expected to rise somewhat less than prices during the next two years; wage increases are projected to accelerate only slightly and productivity growth is expected to slow to about trend rates.

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

February 6, 1985

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						
12/12/84	2/6/85	12/12/84	2/6/85	12/12/84	2/6/85	12/12/84	2/6/85	12/12/84	2/6/85			
Annual changes:												
1983	<1>	7.7	7.7	3.7	3.7	3.8	3.8	4.6	4.6	9.6	9.6	
1984	<1>	10.7	10.8	6.7	6.8	4.1	4.0	4.4	4.3	7.5	7.5	
1985		6.8	7.2	2.7	3.6	4.1	3.7	4.5	4.3	7.1	6.9	
1986			6.7		3.0		3.9		4.3		6.6	
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>	5.7	5.6	1.9	1.6	4.0	4.0	4.9	4.9	7.5	7.4
	Q4	<1>	5.5	6.4	1.3	3.9	4.3	3.3	4.4	3.8	7.3	7.2
1985	Q1		7.1	8.1	2.4	3.8	4.0	3.7	4.3	4.4	7.2	7.2
	Q2		7.0	7.4	3.2	3.6	4.0	3.7	4.3	4.3	7.1	6.9
	Q3		7.0	6.8	3.2	3.5	4.2	3.8	4.3	4.1	7.1	6.8
	Q4		6.8	6.6	2.8	3.3	4.3	3.8	4.4	4.1	7.0	6.7
1986	Q1			6.7		2.8		3.8		4.2		6.7
	Q2			6.4		2.4		4.0		4.4		6.7
	Q3			6.7		2.7		4.3		4.5		6.6
	Q4			7.0		2.8		4.5		4.5		6.6
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>	5.6	6.0	1.6	2.7	4.2	3.7	4.7	4.4	-.2	-.3
1985	Q2		7.0	7.8	2.8	3.7	4.0	3.7	4.3	4.3	-.2	-.3
	Q4		6.9	6.7	3.0	3.4	4.2	3.8	4.3	4.1	-.1	-.2
1986	Q2			6.6		2.6		3.9		4.3		.0
	Q4			6.9		2.8		4.4		4.5		-.1
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>	9.1	9.3	5.0	5.6	4.2	4.0	4.5	4.4	-1.2	-1.3
1985	Q4		7.0	7.2	2.9	3.6	4.1	3.8	4.3	4.2	-.3	-.5
1986	Q4			6.7		2.7		4.2		4.4		-.1

<1> Actual.

<2> Percent change from two quarters earlier.

<3> Percent change from four quarters earlier.

February 6, 1985

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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.)

	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	3752.5
Final sales	3216.8	3286.4	3350.9	3419.0	3479.5	3594.1	3622.8	3721.4
Private	2538.0	2604.2	2661.1	2727.6	2775.1	2850.4	2861.8	2938.7
Domestic final purchases	2518.4	2610.7	2677.5	2757.4	2826.6	2909.1	2952.4	3003.0
Personal consumption expenditures	2070.4	2141.6	2181.4	2230.2	2276.5	2332.7	2361.4	2398.6
Goods	1034.6	1073.0	1095.8	1122.8	1152.2	1179.0	1178.6	1196.8
Services	1035.8	1068.6	1085.7	1107.5	1124.4	1153.7	1182.8	1201.8
Gross private domestic investment	405.0	449.6	491.9	540.0	623.8	627.0	662.8	635.5
Residential structures	113.3	129.8	142.3	143.4	151.2	155.6	155.3	155.4
Business fixed investment	334.6	339.3	353.9	383.9	398.8	420.8	435.7	448.9
Change in business inventories	-42.9	-19.4	-4.3	12.7	73.8	30.6	71.8	31.1
Nonfarm	-32.6	-5.4	11.6	14.1	60.6	47.0	63.7	22.1
Net exports of goods and services <1>	19.6	-6.5	-16.4	-29.8	-51.5	-58.7	-90.6	-64.3
Exports	328.5	328.1	342.0	346.1	358.9	362.4	368.6	364.7
Imports	308.9	334.5	358.4	375.9	410.4	421.1	459.3	429.0
Gov't. purchases of goods and services	678.8	682.2	689.8	691.4	704.4	743.7	761.0	782.7
Federal <2>	273.0	270.5	269.2	266.3	267.6	296.4	302.0	316.1
State and local	405.8	411.6	420.6	425.1	436.8	447.4	458.9	466.6
Gross national product in constant (1972) dollars	1491.0	1524.8	1550.2	1572.7	1610.9	1638.8	1645.2	1661.1
Personal income	2662.8	2714.7	2763.3	2836.5	2920.5	2984.5	3047.3	3100.4
Wage and salary disbursements	1608.1	1642.1	1671.3	1715.4	1755.7	1793.1	1819.5	1846.1
Disposable personal income	2261.4	2302.9	2367.4	2428.8	2502.2	2554.3	2606.4	2649.4
Saving rate (percent)	5.7	4.2	5.0	5.3	6.1	5.7	6.3	6.3
Corporate profits with I.V.A. and C.C. Adj.	179.0	216.6	245.0	260.0	277.4	291.2	282.8	286.8
Corporate profits before tax	161.6	198.1	227.4	225.5	243.3	246.2	224.8	223.0
Federal government surplus or deficit (-) (N.I.A. basis)	-185.8	-167.3	-180.9	-180.5	-161.3	-163.9	-180.6	-199.9
High employment surplus or deficit (-) <3>	-88.9	-74.2	-102.5	-113.1	-113.3	-129.6	-146.1	-170.8
State and local government surplus or deficit(-) (N.I.A. basis)	34.0	43.8	47.4	51.2	54.0	54.3	47.6	52.0
Excluding social insurance funds	-2.0	6.9	9.5	12.0	13.5	12.4	4.3	7.5
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	90.4	91.7	92.8	93.8	94.6	95.4
Manufacturing	18.1	18.3	18.6	19.0	19.4	19.6	19.7	19.7
Industrial production (1967=100)	138.5	144.5	151.8	155.5	159.8	163.1	165.6	165.3
Capacity utilization all manufacturing (percent)	78.7	73.9	77.4	78.9	80.7	81.8	82.5	81.9
Materials (percent)	70.1	73.5	77.5	79.6	81.6	82.7	82.9	81.4
Housing starts, private (million units, A.R.)	1.64	1.69	1.78	1.70	1.97	1.90	1.66	1.56
New auto sales (millions, A.R.)	8.46	9.10	9.22	9.94	10.46	10.68	10.32	9.77
Domestic models	6.06	6.81	6.92	7.29	8.16	8.26	7.97	7.01
Foreign models	2.40	2.28	2.31	2.65	2.30	2.42	2.34	2.76

<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.

I-9
PERCENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Annual rates compounded quarterly)

February 6, 1985

	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	3.9
Final sales	1.1	6.4	4.9	4.2	3.6	10.3	-1.0	8.2
Private	3.5	8.6	6.2	6.3	4.2	8.5	-2.4	8.6
Domestic final purchases	4.0	12.1	6.9	9.7	7.6	9.5	2.3	4.8
Personal consumption expenditures	2.6	10.0	3.8	6.8	4.6	7.9	.7	3.9
Goods	3.5	12.6	5.4	9.5	7.8	10.7	-1.9	5.1
Services	1.5	7.3	2.1	3.8	1.2	4.6	3.8	2.5
Gross private domestic investment	34.0	52.5	38.4	37.0	71.5	-2.2	24.9	-14.0
Residential structures	64.4	78.5	31.6	4.0	20.8	1.3	-4.6	-1.7
Business fixed investment	.2	9.5	18.7	30.6	20.5	21.4	13.7	11.1
Gov't. purchases of goods and services	-8.1	-2.6	-.5	-4.3	1.0	18.6	5.4	6.6
Federal	-17.3	-5.9	-5.3	-8.7	-2.8	45.4	6.2	13.7
National defense	7.0	7.4	-1.9	9.2	3.8	12.0	-2.3	14.4
State and local	-1.1	-.2	2.7	-1.4	3.5	3.7	4.8	1.9
Disposable personal income	2.1	3.4	7.7	8.2	8.6	6.3	3.9	4.2
<u>Current Dollars</u>								
Gross national product	8.5	12.3	10.1	10.6	14.9	10.7	5.6	6.4
Final sales	5.9	8.9	8.1	8.4	7.3	13.8	3.2	11.3
Private	8.0	10.8	9.0	10.4	7.1	11.3	1.6	11.2
Domestic final purchases	5.7	15.5	10.6	12.5	10.4	12.2	6.1	7.0
Personal consumption expenditures	4.8	14.5	7.6	9.3	8.6	10.2	5.0	6.5
Goods	3.6	15.7	8.8	10.2	10.9	9.6	-.1	6.3
Services	6.1	13.3	6.6	8.3	6.2	10.8	10.5	6.6
Gross private domestic investment	34.3	51.9	43.2	45.3	78.1	2.1	24.9	-15.5
Residential structures	79.4	72.3	44.4	3.3	23.6	12.2	-.6	.1
Business fixed investment	-5.4	5.7	18.5	38.4	16.5	24.0	14.9	12.7
Gov't. purchases of goods and services	-1.3	2.0	4.5	.9	7.7	24.3	9.6	11.9
Federal	-8.9	-3.6	-2.0	-4.3	2.0	50.5	7.8	19.9
National defense	8.0	9.8	3.3	13.2	12.5	14.6	-.8	21.8
State and local	4.2	5.8	9.0	4.4	11.5	10.1	10.7	6.9
Disposable personal income	4.3	7.5	11.7	10.7	12.7	8.6	8.4	6.8
Personal income	3.6	8.0	7.3	11.0	12.4	9.1	8.7	7.2
Wage and salary disbursements	5.6	8.7	7.3	11.0	9.7	8.8	6.0	6.0
Corporate profits with I.V.A. and C.C.Adj.	93.9	114.4	63.7	26.8	29.8	21.4	-10.9	5.6
Corporate profits before tax	15.4	125.8	73.6	-3.3	35.5	4.9	-30.5	-3.2
Nonfarm payroll employment	.5	3.4	3.7	5.8	4.8	4.5	3.3	3.8
Manufacturing	-.9	5.0	7.0	9.1	7.5	4.5	2.1	1.2
Nonfarm business sector								
Output per hour	4.4	8.1	2.1	1.0	2.9	5.5	-1.1	1.7
Compensation per hour	5.7	3.5	2.2	4.1	6.1	3.7	3.6	3.5
Unit labor costs	1.3	-4.2	.1	3.0	3.1	-1.7	4.7	1.8
GNP implicit deflator <1>	5.0	2.6	3.1	4.4	4.4	3.3	3.9	2.4
Gross domestic business product								
fixed-weighted price index <2>	2.7	3.9	4.5	3.5	4.2	4.1	4.0	3.3
Excluding food and energy	4.9	3.5	5.4	3.8	3.4	5.4	4.9	3.8
Consumer price index (all urban)	.3	4.4	4.1	4.5	5.0	3.7	3.5	3.9
Industrial production	10.1	18.4	21.8	10.2	11.5	8.6	6.3	-.8

<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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CLASS II FOMC

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

	Projected							
	1985				1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3826.7	3895.4	3960.0	4023.9	4090.0	4154.0	4221.9	4294.4
Final sales	3787.5	3859.2	3925.2	3989.5	4055.8	4119.4	4187.4	4259.4
Private	2988.7	3046.6	3097.6	3147.6	3200.7	3252.8	3308.5	3366.6
Domestic final purchases	3063.7	3128.5	3192.5	3251.2	3305.9	3359.8	3418.4	3477.9
Personal consumption expenditures	2445.5	2493.2	2540.4	2585.4	2627.7	2672.0	2717.8	2762.6
Goods	1219.1	1240.2	1261.1	1280.0	1296.9	1314.2	1332.2	1350.7
Services	1226.4	1253.0	1279.3	1305.4	1330.8	1357.8	1385.6	1412.0
Gross private domestic investment	657.4	671.5	686.9	700.2	712.3	722.4	735.1	750.2
Residential structures	157.7	163.8	170.2	173.9	176.2	176.0	179.2	184.6
Business fixed investment	460.5	471.5	481.9	491.9	501.9	511.8	521.4	530.6
Change in business inventories	39.2	36.2	34.8	34.4	34.2	34.6	34.5	35.0
Nonfarm	35.2	34.2	34.8	34.4	34.2	34.6	34.5	35.0
Net exports of goods and services <1>	-75.0	-81.8	-94.9	-103.6	-105.2	-107.0	-109.9	-111.3
Exports	361.3	364.3	370.1	377.3	384.4	391.7	400.6	411.6
Imports	436.3	446.1	465.0	480.9	489.6	498.7	510.6	522.8
Gov't. purchases of goods and services	798.8	812.5	827.6	841.8	855.1	866.6	878.9	892.8
Federal <2>	323.8	329.2	335.9	341.9	347.3	350.8	355.0	360.6
State and local	475.0	483.3	491.7	499.9	507.8	515.8	523.9	532.2
Gross national product in constant (1972) dollars	1676.6	1691.6	1706.2	1720.1	1732.1	1742.6	1754.2	1766.5
Personal income	3166.3	3221.5	3276.3	3338.6	3389.2	3447.4	3504.6	3563.7
Wage and salary disbursements	1884.1	1918.2	1951.3	1985.4	2019.4	2051.5	2082.8	2116.6
Disposable personal income	2707.7	2753.0	2797.0	2847.1	2896.8	2945.8	2993.8	3043.1
Saving rate (percent)	6.5	6.2	5.9	5.9	5.9	5.9	5.8	5.8
Corporate profits with I.V.A. and C.C. Adj.	290.4	295.3	297.3	293.4	290.7	290.0	293.2	297.5
Corporate profits before tax	222.4	225.8	226.8	220.4	212.2	208.5	208.2	209.5
Federal government surplus or deficit (-) (N.I.A. basis)	-200.7	-200.3	-199.1	-194.8	-191.6	-192.6	-193.7	-194.1
High employment surplus or deficit (-) <3>	-175.5	-179.1	-181.1	-179.4	-177.1	-177.8	-179.5	-181.0
State and local government surplus or deficit(-) (N.I.A. basis)	54.1	57.1	56.0	52.9	51.2	50.4	50.5	50.7
Excluding social insurance funds	9.0	11.5	9.9	6.3	4.1	2.8	2.4	2.1
Civilian labor force (millions)	114.8	115.3	115.8	116.3	116.8	117.3	117.7	118.1
Unemployment rate (percent)	7.2	6.9	6.8	6.7	6.7	6.7	6.6	6.6
Nonfarm payroll employment	96.3	97.1	97.8	98.4	98.9	99.4	99.8	100.3
Manufacturing	19.9	20.0	20.1	20.2	20.3	20.4	20.5	20.5
Industrial production (1967=100)	167.5	169.3	171.1	172.7	174.0	175.4	176.7	178.1
Capacity utilization: all manufacturing (percent)	82.4	82.5	82.7	82.7	82.7	82.6	82.6	82.6
Materials (percent)	81.9	82.2	82.4	82.5	82.5	82.5	82.5	82.5
Housing starts, private (million units, A.R.)	1.70	1.80	1.75	1.75	1.75	1.75	1.75	1.80
New auto sales (millions, A.R.)	10.85	10.95	11.05	11.05	10.95	10.85	10.75	10.65
Domestic models	8.40	8.40	8.35	8.30	8.40	8.25	7.95	7.75
Foreign models	2.45	2.55	2.70	2.75	2.55	2.60	2.80	2.90

<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.

February 6, 1985

CONFIDENTIAL - FR
CLASS II FOMCPERCENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Annual rates compounded quarterly)

	Projected							
	1985				1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	3.8	3.6	3.5	3.3	2.8	2.4	2.7	2.8
Final sales	3.0	4.1	3.8	3.4	2.9	2.5	2.8	2.8
Private	3.3	4.3	3.8	3.5	3.1	2.7	3.0	3.0
Domestic final purchases	5.4	5.3	4.7	3.8	3.1	2.6	2.8	2.6
Personal consumption expenditures	4.9	4.5	3.8	3.3	2.7	2.6	2.5	2.0
Goods	6.0	5.3	4.4	3.6	2.7	2.5	2.3	2.0
Services	3.7	3.6	3.1	3.0	2.7	2.7	2.6	2.0
Gross private domestic investment	11.9	5.6	6.1	4.9	4.1	2.6	3.7	4.7
Residential structures	2.8	12.2	12.4	5.1	1.5	-4.6	3.1	8.2
Business fixed investment	8.7	7.4	6.6	6.1	5.5	4.8	4.4	4.1
Gov't. purchases of goods and services	1.9	3.0	3.6	3.3	2.1	1.4	1.7	2.2
Federal	1.1	4.0	5.2	4.7	2.4	.6	1.4	2.7
National defense	6.7	7.0	6.0	4.2	2.1	1.2	2.5	4.1
State and local	2.5	2.4	2.4	2.3	1.9	1.9	1.9	1.9
Disposable personal income	6.0	3.4	2.6	3.4	3.1	2.6	2.1	2.0
<u>Current Dollars</u>								
Gross national product	8.1	7.4	6.8	6.6	6.7	6.4	6.7	7.0
Final sales	7.3	7.8	7.0	6.7	6.8	6.4	6.8	7.1
Private	7.0	8.0	6.9	6.6	6.9	6.7	7.0	7.2
Domestic final purchases	8.3	8.7	8.4	7.6	6.9	6.7	7.2	7.1
Personal consumption expenditures	8.1	8.0	7.8	7.3	6.7	6.9	7.0	6.8
Goods	7.7	7.1	6.9	6.1	5.4	5.4	5.6	5.7
Services	8.4	9.0	8.7	8.4	8.0	8.4	8.5	7.8
Gross private domestic investment	14.5	8.9	9.5	8.0	7.1	5.8	7.2	8.5
Residential structures	6.1	16.4	16.6	9.0	5.4	-.5	7.5	12.6
Business fixed investment	10.7	9.9	9.1	8.6	8.4	8.1	7.7	7.3
Gov't. purchases of goods and services	8.5	7.0	7.6	7.1	6.5	5.5	5.8	6.5
Federal	10.1	6.8	8.4	7.3	6.5	4.1	4.9	6.5
National defense	14.6	10.0	9.5	7.4	6.4	4.7	6.4	8.2
State and local	7.4	7.2	7.1	6.9	6.5	6.4	6.4	6.5
Disposable personal income	9.1	6.9	6.5	7.4	7.2	6.9	6.7	6.7
Personal income	8.8	7.2	7.0	7.8	6.2	7.0	6.8	6.9
Wage and salary disbursements	8.5	7.4	7.1	7.2	7.0	6.5	6.2	6.6
Corporate profits with I.V.A. and C.C.Adj.	5.1	7.0	2.7	-5.1	-3.7	-1.0	4.5	6.0
Corporate profits before tax	-1.1	6.3	1.7	-10.7	-14.1	-6.9	-.5	2.5
Nonfarm payroll employment	3.7	3.2	2.9	2.6	2.1	1.9	1.8	1.9
Manufacturing	2.7	2.6	2.3	2.0	2.0	1.4	1.4	1.4
Nonfarm business sector								
Output per hour	1.3	.8	1.1	1.3	1.0	.8	1.2	1.3
Compensation per hour	4.4	4.2	4.3	4.4	4.9	4.6	4.7	4.8
Unit labor costs	3.1	3.4	3.2	3.1	3.8	3.8	3.5	3.5
GNP implicit deflator <1>	4.2	3.6	3.2	3.2	3.8	3.9	3.9	4.1
Gross domestic business product								
fixed-weighted price index <2>	3.7	3.7	3.8	3.8	3.8	4.0	4.3	4.5
Excluding food and energy	4.4	4.3	4.1	4.1	4.2	4.4	4.5	4.5
Consumer price index (all urban)	3.5	3.7	3.9	4.1	4.1	4.1	4.3	4.6
Industrial production	5.4	4.3	4.4	3.7	3.2	3.1	3.1	3.2

<1> Excluding Federal pay increase, the rate of change in 1985-Q1 is 3.7 percent and in 1986-Q1 is 3.7 percent.
 <2> Uses expenditures in 1972 as weights.

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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	3661.3	3926.5	4190.1
Final sales	2403.5	2641.4	2931.7	3095.4	3318.3	3604.5	3890.3	4155.5
Private	1929.2	2103.7	2335.2	2444.9	2632.7	2856.5	3070.1	3282.1
Domestic final purchases	1915.9	2079.7	2307.2	2425.9	2641.0	2922.8	3159.0	3390.5
Personal consumption expenditures	1507.1	1668.0	1849.1	1984.9	2155.9	2342.3	2516.1	2695.0
Goods	813.4	883.5	966.1	1002.6	1081.5	1176.6	1250.1	1323.5
Services	693.7	784.5	883.0	982.2	1074.4	1165.7	1266.0	1371.6
Gross private domestic investment	423.0	401.9	484.2	414.9	471.6	637.3	679.0	730.0
Residential construction	118.5	102.9	104.3	91.3	132.2	154.4	166.4	179.0
Business fixed investment	290.2	308.8	353.9	349.6	352.9	426.0	476.4	516.4
Change in business inventories	14.3	-9.8	26.0	-26.1	-13.5	56.8	36.2	34.6
Nonfarm	8.6	-4.5	18.2	-23.9	-3.1	48.4	34.7	34.6
Net exports of goods and services <1>	13.2	23.9	28.0	19.0	-8.3	-66.3	-88.8	-108.3
Exports	281.3	338.8	369.9	348.4	336.2	363.6	368.3	397.1
Imports	268.1	314.8	341.9	329.4	344.4	430.0	457.1	505.4
Gov't. purchases of goods and services	474.4	537.8	596.5	650.5	685.5	747.9	820.2	873.4
Federal <2>	168.3	197.0	228.9	258.9	269.7	295.5	332.7	353.4
State and local	306.0	340.8	367.6	391.5	415.8	452.4	487.5	519.9
Gross national product in constant (1972) dollars	1479.4	1475.0	1512.1	1480.0	1534.7	1639.0	1698.6	1748.9
Personal income	1951.1	2165.3	2429.4	2584.6	2744.3	3013.2	3250.6	3476.2
Wage and salary disbursements	1237.6	1356.7	1493.1	1568.7	1659.2	1803.6	1934.8	2067.6
Disposable personal income	1650.2	1828.9	2041.7	2180.5	2340.1	2578.1	2776.2	2969.9
Saving rate (percent)	5.9	6.0	6.7	6.2	5.0	6.1	6.1	5.9
Corporate profits with I.V.A. and C.C.Adj.	194.8	175.4	190.0	159.2	225.1	284.6	294.1	292.9
Corporate profits before tax	252.7	234.6	221.3	165.6	203.1	234.3	223.9	209.6
Federal government surplus or deficit (-) (N.I.A. basis)	-16.1	-61.3	-64.2	-148.2	-178.6	-176.4	-198.7	-193.0
High employment surplus or deficit (-)	-20.8	-36.4	-31.3	-61.6	-92.7	-140.0	-178.8	-178.8
State and local government surplus or deficit (-) (N.I.A. basis)	30.4	30.6	37.6	32.9	44.1	52.0	55.0	50.7
Excluding social insurance funds	6.8	3.5	7.8	-8	6.6	9.5	9.2	2.8
Civilian labor force (millions)	105.0	107.0	108.7	110.2	111.5	113.5	115.5	117.5
Unemployment rate (percent)	5.8	7.1	7.6	9.7	9.6	7.5	6.9	6.6
Nonfarm payroll employment (millions)	89.8	90.4	91.2	89.6	90.1	94.2	97.4	99.6
Manufacturing	21.0	20.3	20.2	18.8	18.5	19.6	20.0	20.4
Industrial production (1967=100)	152.5	147.0	150.9	138.6	147.6	163.4	170.1	176.0
Capacity utilization: all manufacturing (percent)	86.0	79.6	79.4	71.1	75.2	81.7	82.6	82.6
Materials (percent)	87.6	80.4	80.7	70.1	75.2	82.1	82.3	82.5
Housing starts, private (million units, A.R.)	1.72	1.30	1.10	1.06	1.70	1.77	1.75	1.76
New auto sales (millions, A.R.)	10.68	9.04	8.56	8.00	9.18	10.31	10.98	10.80
Domestic models	8.36	6.62	6.24	5.77	6.79	7.85	8.36	8.09
Foreign models	2.32	2.42	2.32	2.23	2.39	2.46	2.61	2.71

<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.

	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	3.6	3.0
Final sales	3.5	.5	1.5	-.7	3.2	5.0	4.2	3.1
Private	4.0	.1	1.6	-1.3	4.1	5.3	4.1	3.2
Domestic final purchases	2.9	-1.0	2.2	-.2	5.6	7.6	4.9	3.4
Personal consumption expenditures	2.7	.5	2.0	1.3	4.8	5.3	4.1	3.0
Goods	1.9	-1.4	1.7	.4	6.0	7.2	4.6	3.1
Services	3.7	2.7	2.3	2.5	3.4	3.2	3.4	2.8
Gross private domestic investment	-.2	-11.8	10.7	-15.9	13.7	31.1	4.8	4.3
Residential structures	-5.3	-20.3	-5.5	-14.8	41.7	12.3	3.9	3.5
Business fixed investment	7.3	-2.4	5.5	-4.6	2.5	20.0	9.8	5.5
Gov't. purchases of goods and services	1.3	2.2	.9	2.0	-.3	3.5	4.7	2.4
Federal	1.8	4.2	3.7	6.1	-.7	5.3	7.6	2.8
National defense	2.6	3.9	5.0	7.6	7.1	5.6	7.0	3.3
State and local	1.1	1.0	-.6	-.6	.0	2.3	2.7	2.1
Disposable personal income	2.7	.6	2.7	.9	3.5	6.8	4.3	2.8
<u>Current Dollars</u>								
Gross national product	11.7	8.8	12.4	3.8	7.7	10.8	7.2	6.7
Final sales	12.4	9.9	11.0	5.6	7.2	8.6	7.9	6.8
Private	13.1	9.0	11.0	4.7	7.7	8.5	7.5	6.9
Domestic final purchases	12.3	8.5	10.9	5.1	8.9	10.7	8.1	7.3
Personal consumption expenditures	11.9	10.7	10.9	7.3	8.6	8.6	7.4	7.1
Goods	11.7	8.6	9.3	3.8	7.9	8.8	6.2	5.9
Services	12.2	13.1	12.6	11.2	9.4	8.5	8.6	8.3
Gross private domestic investment	9.4	-5.0	20.5	-14.3	13.7	35.1	6.5	7.5
Residential structures	6.6	-13.2	1.3	-12.4	44.7	16.8	7.8	7.6
Business fixed investment	16.6	6.4	14.6	-1.2	.9	20.7	11.8	8.4
Gov't. purchases of goods and services	9.8	13.4	10.9	9.0	5.4	9.1	9.7	6.5
Federal	9.6	17.1	16.2	13.1	4.2	9.6	12.6	6.2
National defense	11.5	17.3	17.2	16.8	11.7	10.5	11.8	7.0
State and local	9.9	11.4	7.9	6.5	6.2	8.8	7.8	6.7
Disposable personal income	12.0	10.8	11.6	6.8	7.3	10.2	7.7	7.0
Personal income	12.6	11.0	12.2	6.4	6.2	9.8	7.9	6.9
Wage and salary disbursements	11.9	9.6	10.1	5.1	5.8	8.7	7.3	6.9
Corporate profits with I.V.A. and C.C.Adj.	1.2	-9.9	8.3	-16.2	41.5	26.4	3.4	-.4
Corporate profits before tax	10.3	-7.1	-5.7	-25.2	22.8	15.3	-4.5	-6.4
Nonfarm payroll employment	3.6	.7	.8	-1.7	.6	4.5	3.4	2.3
Manufacturing	2.6	-3.6	-.6	-6.9	-1.5	5.9	2.3	1.8
Nonfarm business sector								
Output per hour	-1.5	-.7	1.5	.2	3.5	3.1	.8	1.1
Compensation per hour	9.0	10.3	9.6	8.0	4.9	4.6	3.5	4.6
Unit labor costs	10.7	11.1	8.0	7.7	1.4	1.5	2.8	3.5
GNP implicit deflator	8.6	9.2	9.6	6.0	3.8	3.7	3.5	3.6
Gross domestic business product								
fixed-weighted price index <1>	9.9	10.0	9.6	6.0	3.8	4.0	3.7	3.9
Excluding food and energy	8.6	8.5	9.4	7.0	4.6	4.3	4.3	4.3
Consumer price index (all urban)	11.3	13.5	10.3	6.1	3.2	4.2	3.7	4.1
Industrial production	4.4	-3.6	2.6	-8.1	6.4	10.8	4.1	3.5

<1> Uses expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS
(Billions of dollars)

	Fiscal Year 1984*	FY1985 ^e /2/		FY1986 ^e /2/		CY 1984*	FY1985 ^e FRB Staff	FRB staff estimates								
		Admin. 1/	FRB Staff	Admin. 1/	FRB Staff			Calendar quarters; not seasonally adjusted								
								1984			1985			1986		
								IV*	I	II	III	IV	I	II	III	
Unified budget receipts	666	737	735	794	787	683	745	166	172	210	188	175	182	233	198	
Unified budget outlays	842	947	941	972	976	867	953	239	234	234	235	251	242	246	237	
Surplus/deficit(-), unified budget	-175	-210	-206	-178	-189	-184	-208	-73	-62	-24	-48	-76	-60	-13	-39	
Surplus/deficit(-), off-budget agencies ³	-10	-12	-12	-2	-5	-10	-14	1	-3	-5	-5	-1	-1	-2	-1	
Combined deficit to be financed	-185	-222	-218	-180	-194	-195	-222	-72	-65	-29	-53	-77	-61	-15	-40	
Means of financing combined deficit:																
Net borrowing from public	171	201	198	173	195	198	205	64	49	35	51	73	62	15	45	
Decrease in cash operating balance	7	10	15	0	-5	-5	7	13	7	-2	-3	5	-5	0	-5	
Other ⁴	8	10	5	7	4	2	9	-6	9	-4	5	-1	4	0	0	
Cash operating balance, end of period	30	20	15	20	20	17	10	17	10	12	15	10	15	15	20	
Memo: Sponsored agency borrowing ⁵	30	42	20	46	20	32	21	4	5	6	5	5	5	5	5	
NIA Budget																
Receipts	688	758	745	827	807	704	762	718	740	755	770	785	801	814	827	
Expenditures	860	948	945	992	1000	880	961	917	940	955	969	980	993	1006	1020	
Purchases	283	327	326	355	349	296	333	316	324	329	336	342	347	351	355	
Defense	215	242	242	272	261	221	248	231	239	245	251	255	259	262	266	
Nondefense	68	85	85	83	88	74	85	85	84	84	85	87	88	89	89	
All other expenditures	577	621	619	637	651	584	628	601	616	626	633	638	646	655	665	
Surplus/deficit(-)	-172	-190	-200	-166	-193	-176	-199	-200	-201	-200	-199	-195	-192	-193	-194	
High employment surplus/deficit(-) evaluated at 6 percent unemployment	-126	n.a.	-177	n.a.	-179	-140	-179	-171	-176	-179	-181	-179	-177	-178	-180	

*--actual

e--estimated

n.a.--not available

1. Budget of the United States Government, Fiscal Year 1986 (February 1985).

2. The CBO baseline budget estimates show revenues of \$735 billion and \$788 billion, unified outlays of \$938 billion and \$995 billion, and deficits of \$203 billion and \$206 billion in fiscal years 1985 and 1986, respectively. Off-budget outlays are projected to be \$11 billion in fiscal 1985 and \$9 billion in fiscal 1986. (The Economic Outlook, February 1985.)

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), FNMA (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. Growth in the monetary aggregates remained strong in the December and January period. M1 grew at about an 11 percent annual rate in both months. (All rates cited here are prior to revisions for new benchmarks and new seasonal factors; the revised data will appear in the Bluebook). The strength in M1 late last year and early this year appears to be associated with the pickup in economic activity and the lagged effects of the lower level of short-term interest rates that has prevailed since last fall.

M2 rose at 15 and 12 percent rates in December and January, respectively. It does not appear that the reductions in minimum balances on Super NOW and MMDA accounts, from \$2,500 to \$1,000 on January 1, contributed to the growth of either M1 or M2. The strength of the nontransactions component of M2 apparently continued to reflect sluggish adjustments of rates on MMDAs and money funds to market rate declines. M3 growth slowed from 14 percent in December to about 10 percent in January; growth in large-denomination time deposits moderated, owing in part to the strength in core deposits and slowing in bank credit growth.

Short-term interest rates were roughly unchanged through most of the intermeeting period, while the federal funds rate traded mostly in an 8 to 8-3/8 percent range following the cut in the discount rate to 8 percent on December 21. Late in the period, however, the funds rate rose briefly, and other interest rates backed up amid concerns about a tightening of System policy in view of the rapid growth of money and resumed strength in economic activity. Longer-term market rates fluctuated rather widely over the period but, on balance, these rates are about unchanged to down

about 20 basis points, for corporate bonds, in the wake of favorable inflation news.

Growth in the debt of domestic nonfinancial sectors appears to have slackened recently. Federal borrowing in the first quarter of this year is under less pressure from the need to refinance HUD project notes, and borrowing needs are also reduced by the seasonal upswing in tax collections. Net borrowing from the public (not seasonally adjusted) is expected to decline from \$64 billion in the final quarter of 1984 to about \$49 billion in the current quarter, but the reduction in pressures from the federal sector is not as great as these figures would imply since part of the deficit will be financed by a decline in the Treasury's cash balance.

In the tax-exempt bond market, financing demands also have been reduced following the rush to market of private-purpose issues at the end of last year. Long-term debt issuance in January is estimated to have fallen sharply from the December pace to a rate well below the average for all of last year. As a result of this decline, the ratio of tax-exempt to taxable bond yields has fallen considerably from the peak at the time of the last FOMC meeting.

In the private sector, consumer credit has continued to expand at an exceptional pace. In December, growth in consumer installment debt may have exceeded the rapid pace of the preceding month, and this component of bank credit growth was also quite strong in January. Mortgage lending activity at saving and loan associations, however, remained relatively subdued through December and real estate loans at commercial banks, through January, have shown no signs of acceleration. Interest rates on home loans have remained on a downward trend, in the case of fixed-rate

loans lagging earlier declines in other long-term credit markets.

There also seems to have been a slowing in growth of outstanding business credit in December and January. Despite what appears to be only a slight decline in growth of merger-related debt, both short- and long-term borrowing by nonfinancial businesses has slowed from the very rapid pace in October and November. In December, gross bond issuance by nonfinancial corporations in domestic and Euro markets combined dropped to roughly half the rapid November pace, perhaps because some firms were hoping for a further decline in corporate bond rates. Although the pace of bond issuance picked up in January, particularly in Euromarkets, it remained well below the fourth-quarter average. Meanwhile, short-term credit demands also slackened, with growth in both commercial and industrial loans at banks and commercial paper dropping off despite two cuts in the prime rate and lower short-term rates generally. This slackening of growth in business credit demands may reflect improved cash flows and reduced needs to finance inventories at the end of the year.

Outlook. The pace of credit growth for all nonfinancial sectors combined may be somewhat slower, on a seasonally adjusted basis, in the current quarter than last quarter. However, fundamentals affecting financial markets are likely to be little changed in the near term. In a number of sectors--the federal government, state and local, and nonfinancial business--it appears that the drop-off in credit market demands will be associated in good part with lessened accumulation of financial assets.

Federal credit demands are likely to remain strong as the fiscal year deficit is expected to exceed last year's level. Similarly, although the state and local sector is curbing its borrowing on behalf of the

private sector, general obligation borrowing does not seem likely to be reduced.

In the nonfinancial business sector, the gap between total capital outlays (including inventories) and internal funds is expected to be larger in the current quarter as a whole than in the fourth quarter of last year, and is likely to rise somewhat further in the second quarter. The recent lull in business borrowing, particularly in short-term financing, is likely to come to an end soon.

In the household sector, growth in consumer credit seems likely to decelerate somewhat, with new credit extensions slowing a bit relative to spending--a typical cyclical pattern--while repayments pick up. At the same time, however, mortgage credit demands seem likely to strengthen in response to the lower level of mortgage interest rates.

On balance, the outlook for credit demands and supplies suggests that over the next few months short-term interest rates may remain a little above the lowest levels reached early this year. The same forces also apply to long-term rates, but market psychology could be affected considerably by prospects for the federal budget and the outlook for oil prices and other factors having a major bearing on inflation.

INTERNATIONAL DEVELOPMENTS

Recent Developments. The trade-weighted value of the dollar has risen by more than 4 percent since the December FOMC meeting, to a record level. The dollar has risen most sharply -- by about 7 percent -- against sterling and the Swiss franc; it has risen 4 percent against the German mark. Sterling has been under downward pressure throughout the period, partly because of the importance of oil to Britain's exports and the general softness of world oil prices, but also because of a perceived initial unwillingness on the part of the British government to tighten its policies in the face of high unemployment. Similarly, when downward pressure on the Swiss franc developed -- for reasons that are not apparent -- Swiss authorities were thought to be reluctant to jeopardize their monetary objectives by intervening in exchange markets.

. The Desk made total dollar sales of \$241.5 million -- \$192.7 million against marks and \$48.8 million against yen, shared equally between the System and the Treasury. The series of highly visible and occasionally coordinated sales of dollars by a number of central banks, following the G-5 announcement on intervention on January 17, seemed to slow the dollar's rise for awhile.

A sharp decline in the deficit on merchandise trade in December reduced the deficit for the fourth quarter to an estimated annual rate

of \$92 billion, from a rate of \$132 billion in the third quarter. For the full year 1984, the deficit was \$108 billion -- about \$45 billion larger than in 1983.

Exports increased somewhat in the fourth quarter. Much of the rise in value comprised increased shipments of grain to the Soviet Union, which experienced very poor harvests last summer. The volume of nonagricultural exports increased only slightly, but nevertheless was 9-1/2 percent higher than in the fourth quarter of 1983. The volume of nonoil imports in the fourth quarter dropped from the extraordinarily high rate in the third quarter, but was still 12 percent higher than a year earlier.

Recorded net capital inflows were large in October and November. As recorded in the U.S. international transactions accounts, net inflows into banks in the United States were \$8 billion in October-November. Official reserve assets held in the United States increased \$5 billion. G-10 countries and some developing countries -- including some in Latin America -- increased their holdings. In contrast, OPEC countries' holdings declined further in October-November, with the decline totaling \$8.2 billion in the year through November.

Net foreign private purchases of U.S. corporate and Treasury securities totalled \$11.2 billion in October-November. Although \$2 billion of specially-targeted Treasury securities were sold to foreigners in those months, secondary yields on these are now little different from regular Treasury securities, indicating that the

Treasury is not likely to realize further cost savings by issuing such instruments.

Both U.S. banks and nonfinancial corporations were active issuers in the Eurobond market. Of the almost \$6 billion of issues by the 25 largest bank holding companies in 1984, about half were equity or equity commitment notes, designed to add to banks' primary capital; an additional \$1.9 billion of Eurobonds were issued by these banks in January. Nonfinancial corporate issues were stimulated in part by Japanese regulations that make it attractive for Japanese companies to issue Eurodollar bonds and swap with U.S. companies who have issued Euroyen bonds.

The pace of economic activity in the major foreign industrial countries continues to be uneven. Only in Japan was there strong growth of production in the fourth quarter, according to available data. Provisional data suggest strong growth of GNP in Germany in the fourth quarter, but part of that still seems to reflect a rebound from last summer's strike. Inflation rates have slowed further; in most countries, rates of consumer price inflation reached their lowest levels since the late 1960s or early 1970s. The Japanese and German current account surpluses in 1984 reached \$35 billion and \$6 billion, respectively, while both France and the United Kingdom had balances near zero.

Despite the continued slow real growth, the strong external positions, and the substantial slowing of inflation, monetary authorities in the United Kingdom, Germany, and the Netherlands acted to raise short-term interest rates. The actions -- especially those by

the Bank of England -- were taken in response to downward pressure on the exchange value of their currencies.

Among the developing countries, continued progress in achieving the necessary economic adjustments is far from assured. In Mexico, a 30 percent increase in the minimum wage and the announcement of a planned public sector deficit for 1985 that is larger than earlier envisaged suggest that the resolve of the authorities to follow through on their adjustment program may have weakened. Similarly, the Brazilian IMF program may be in jeopardy; it now appears that Brazil exceeded the ceiling for the public sector borrowing requirement for the end of 1984, and growth in the monetary base in December -- at 37 percent -- was the largest monthly increase ever recorded. The Philippines has fallen out of compliance with an IMF stand-by arrangement approved in December. On December 28 the IMF approved a 15-month stand-by credit for Argentina, though there may have been some slippage in the implementation of the program since the turn of the year. Some progress seems to have been made in Venezuela with regard to private sector debt and the payment of interest arrears. Paris Club reschedulings for both Argentina and the Philippines have been agreed.

Outlook. The staff forecast continues to be based on the conviction that the current high level of the dollar cannot be sustained over the long run. As a consequence, a moderate depreciation of the dollar has been projected to occur during the remainder of this year and during 1986.

The staff projects real GNP to increase at annual rates just under 3 percent (year over year) in foreign industrial countries in

1985 and 1986 (the same rate as in 1984) and at rates of about 3-1/2 percent in the non-OPEC developing countries (somewhat above last year's rate). Inflation rates in foreign industrial countries are projected to be somewhat higher than in the United States in 1985, but somewhat lower in 1986.

The staff now estimates that the U.S. deficit on current account was just under \$100 billion in 1984 and forecasts deficits rising to about \$110 billion and \$130 billion in 1985 and 1986, respectively. The principal forces acting to increase the deficit are the high value of the dollar and the continuing strength of U.S. demand.

The staff forecast for the current account shows a significantly smaller deficit in 1985 than was forecast in the December Greenbook. Underlying the change are downward revisions in the level of imports in the fourth quarter and in the outlook for U.S. oil import prices, which are now assumed to fall about 10 percent from the fourth quarter of 1984 to the fourth quarter of 1986. This view assumes moderate further increases in non-OPEC production and world oil consumption, and the ability of OPEC to restrain their production.

FEBRUARY 6, 1985

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

	1984	ANNUAL		1984		1985				1986			
		1985-P	1986-P	Q3	Q4	Q1-P	Q2-P	Q3-P	Q4-P	Q1-P	Q2-P	Q3-P	Q4-P
1. GNP EXPORTS AND IMPORTS 1/													
CURRENT \$, NET	-66.3	-88.9	-108.4	-90.7	-64.4	-75.0	-81.9	-94.9	-103.6	-105.2	-107.1	-110.0	-111.3
EXPORTS OF G+S	363.6	368.2	397.0	368.6	364.6	361.3	364.2	370.1	377.3	384.3	391.6	400.6	411.5
IMPORTS OF G+S	429.9	457.1	505.4	459.3	429.0	436.3	446.1	465.0	480.9	489.6	498.7	510.6	522.8
CONSTANT 72 \$, NET	-15.5	-27.1	-30.3	-27.0	-15.2	-22.5	-26.1	-29.2	-30.7	-30.9	-30.7	-30.3	-29.2
EXPORTS OF G+S	145.8	144.5	149.1	147.4	146.2	143.4	143.5	144.8	146.3	147.2	148.2	149.6	151.5
IMPORTS OF G+S	161.3	171.6	179.4	174.4	161.4	165.9	169.6	173.9	177.0	178.2	178.9	179.8	180.8
2. U.S. MERCHANDISE TRADE BALANCE 2/	-107.6	-112.7	-131.2	-132.4	-91.5	-99.8	-105.9	-118.5	-126.7	-128.4	-130.1	-132.5	-133.7
EXPORTS	220.3	227.6	244.2	221.9	225.3	224.9	226.2	228.1	231.1	235.0	239.9	246.7	255.4
AGRICULTURAL	38.4	34.9	37.7	36.3	38.6	35.2	34.8	34.6	34.9	36.0	37.1	38.3	39.5
NONAGRICULTURAL	181.9	192.7	206.5	185.7	186.7	189.8	191.3	193.5	196.2	198.9	202.8	208.5	215.8
IMPORTS	327.9	340.3	375.4	354.3	316.8	324.7	332.1	346.6	357.8	363.4	369.9	379.2	389.0
PETROLEUM AND PRODUCTS	57.3	53.9	57.1	57.8	56.4	52.8	51.3	54.7	57.0	55.1	54.9	57.8	60.6
NONPETROLEUM	270.5	286.3	318.3	296.4	260.4	272.0	280.8	291.9	300.8	308.3	315.0	321.4	328.4
3. U.S. CURRENT ACCOUNT BALANCE	-98.6 ^P	-108.9	-132.6	-131.4	-85.6 ^P	-92.8	-100.9	-115.6	-126.5	-127.7	-130.6	-134.5	-137.7
OF WHICH: NET INVESTMENT INCOME	19.8 ^P	15.2	9.7	14.7	19.7 ^P	16.2	15.7	14.9	14.1	11.1	10.1	9.1	8.4
4. FOREIGN OUTLOOK 3/													
REAL GNP--TEN INDUSTRIAL 4/	2.8	3.0	2.8	4.3	3.8	2.9	3.0	3.0	2.7	2.8	2.8	2.9	2.9
REAL GNP--NONOPEC LDC 5/	3.2	3.6	3.6	2.3	3.5	4.3	4.2	3.8	3.5	3.2	3.5	3.9	4.3
CONSUMER PRICES--TEN IND. 4/	4.9	4.1	4.1	2.5	4.7	4.1	4.5	3.9	4.2	4.0	4.3	3.8	4.1

- 1/ NATIONAL INCOME 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.
5/ WEIGHTED BY SHARE IN NONOPEC LDC GNP.
P/ PROJECTED