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May 15, 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. Production growth has been slower in recent months, as a larger share of domestic demand has been satisfied by imports. Consumer spending has maintained upward momentum, and residential construction has increased considerably. Business investment, however, slowed in the first quarter, reflecting weakness in equipment spending. Wage and price increases generally have held in relatively moderate ranges.

The index of industrial production declined 0.2 percent in April, as output in most major market sectors weakened. Auto assemblies fell slightly to 8.1 million units at an annual rate, and output of other consumer goods also edged down. Production of business equipment dropped for the fourth consecutive month. While industrial production has fluctuated in a narrow range since last summer, industrial capacity utilization has trended down, falling 1/2 percentage point last month to about 80-1/2 percent.

The decline in industrial production in April was associated with further cutbacks in manufacturing employment. The 45,000 reduction in manufacturing jobs last month brought the cumulative loss in this sector for the first four months of 1985 to 130,000. Outside of manufacturing, sizable job gains were reported in April in services and in construction. On balance, however, total nonfarm payroll employment rose 215,000 last month—less than the average gains reported in earlier months.

Growth in domestic spending has been well maintained, paced by household sector outlays. Real personal consumption expenditures were up at almost a 5 percent annual rate during the first quarter, with sizable gains in both goods and services. Retail sales, after declining in March,

rebounded in April; excluding auto dealers, gasoline stations, and building materials outlets, nominal sales in April were 1/2 percent above the first-quarter average. Sales of domestic cars since the beginning of April have averaged about an 8-1/2 million unit annual rate—in line with the first-quarter level and up considerably from last year's average pace. Automobile sales have been supported recently by below-market financing incentives offered by manufacturers.

Activity in the housing sector also has continued to improve. Housing starts rose 16 percent in March to a 1.9 million unit annual rate. In the single-family sector, starts moved up to an annual rate of 1.15 million units in March, nearly 20 percent above last summer's low; moreover, sales of both new and existing homes rose sharply last month. Starts of multifamily units also were strong in March, despite high rental vacancy rates in many areas. Multifamily starts have been quite volatile of late, however, and during the six-month period ending in March they were down substantially from the previous half year.

In contrast to the strength in household sector outlays, growth in business spending for fixed capital slowed markedly during the first quarter, as expenditures on producers' durable equipment weakened. Despite some rebound in February and March, shipments by domestic producers of nondefense capital goods fell 3.2 percent in the first quarter; at the same time, imports continued to meet an increased share of business equipment demand. In contrast to equipment spending, nonresidential construction expenditures rose sharply in the first quarter of 1985, though such spending was off noticeably in March.

Sizable increases in energy and automobile prices have pushed up prices at the consumer level in recent months; indeed, a 3.6 percent rise in gasoline prices and higher prices for new and used cars accounted for most of the 0.5 percent increase in the March consumer price index. However, the influence of these factors on inflation is likely to be temporary. Spot prices for gasoline began falling late last month, and motor vehicle prices declined in the April producer price index. In commodity markets, spot prices of industrial materials declined sharply into early May.

Wage data thus far this year have given ambiguous signals. The first-quarter rise in hourly compensation in the nonfarm business sector—6 percent at an annual rate—was about 2 percentage points higher than the annual increases during 1983 and 1984. Less than half of this acceleration can be explained by one-time changes in social security taxes and higher employer contributions for unemployment insurance. By contrast, the first-quarter increase in the employment cost index for wages paid in private industry remained level at a 4-1/4 percent annual rate. Moreover, during the first four months of 1985, the hourly earnings index for production and nonsupervisory workers increased at an annual rate of 2.5 percent, slightly below the 1984 average.

Preliminary estimates suggest that productivity in the nonfarm business sector fell at a 1-1/4 percent annual rate in the first quarter. Temporary declines in measured productivity often occur when output growth slows sharply, as it did in the first quarter, because firms continue to hire based on longer-run sales and production expectations. Declining productivity coupled with rising compensation growth resulted in a sharp jump in unit labor costs last quarter.

Outlook. The staff is projecting a 2-1/4 percent annual rate of growth in real GNP during the current quarter. Domestic final demand is expected to register another quarterly increase on the order of 3-1/2 to 4 percent. Outlays for residential construction are likely to post solid gains, while business fixed investment consumption expenditures are expected to continue to expand. Imports are projected to retrace a bit of their first-quarter surge in the current quarter, so that more of domestic final purchases will be reflected in domestic production. However, some of the rise in final sales is likely to be offset by a slowing in the pace of inventory accumulation, most notably at automobile dealers. The fixed-weighted price index for gross business product is anticipated to rise at a 3-1/2 percent annual rate this quarter—about the same rate as in the first quarter.

Policy assumptions are little changed from the March Greenbook. M1 growth is assumed to be in the upper part of the Committee's range for this year and to slow in 1986. Interest rates are expected to change relatively little over the remainder of 1985 and to trend lower in 1986. On the fiscal policy front, the current fiscal-year deficit is projected at \$206 billion on a unified basis, falling to \$185 billion in FY1986 on the assumption that a deficit-reduction package of about \$50 billion will be adopted. On a structural basis, the federal deficit is expected to remain essentially unchanged through the remainder of 1985 and in 1986.

In this policy environment, growth in aggregate demand is expected to be moderate through the end of the projection period. Real GNP growth is expected to pick up to a bit more than 3 percent on average during the

second half of this year, but then to slow to around 2-1/2 percent in 1986. With increases in real household income likely to be considerably smaller than earlier in the expansion, consumption expenditures are anticipated to rise less rapidly, especially in the case of durables. Advances in business fixed investment also are expected to remain well below the pace of 1983-84. In the equipment area, outlays for high-technology items probably will register further increases as firms continue to seek gains in efficiency and update products. However, with output growth slowing and capacity utilization not rising much above current levels, the cyclical impetus to investment spending is likely to be damped considerably. Moreover, record-high vacancy rates for office buildings in many locales suggest that the boom in commercial construction will not continue. By contrast, activity in single-family housing markets is expected to pick up in response to lower mortgage credit costs. And with the dollar already well below recent peaks and with further moderate declines projected, strengthening of export demand is anticipated for next year. Given the growth path for real GNP, the unemployment rate is projected to level off at 7 percent in 1986.

The outlook for inflation is about as presented in the last Greenbook, with the fixed-weighted price index for gross business product expected to rise 3-1/2 percent this year and 4 percent in 1986. The remaining slack in labor and product markets should hold growth of wages and unit labor costs in check during the next year and a half. However, the anticipated depreciation of the dollar will add somewhat to domestic inflation pressures, especially in 1986.

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

May 15, 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					
	3/20/85	5/15/85	3/20/85	5/15/85	3/20/85	5/15/85	3/20/85	5/15/85	3/20/85	5/15/85		
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>	10.9	10.8	6.9	6.8	4.0	4.0	4.3	4.3	7.5	7.5	
1985		7.1	6.5	3.6	2.8	3.5	3.7	4.1	4.3	7.0	7.2	
1986		6.4	6.3	2.8	2.7	3.8	3.7	4.1	4.0	6.7	7.0	
Quarterly changes:												
1984	Q1	<1>	14.9	14.9	10.1	10.1	4.2	4.2	3.4	3.4	7.9	7.9
	Q2	<1>	10.7	10.7	7.1	7.1	4.1	4.1	5.4	5.4	7.5	7.5
	Q3	<1>	5.6	5.6	1.6	1.6	4.0	4.0	4.9	4.9	7.4	7.4
	Q4	<1>	7.8	7.1	4.9	4.3	3.2	3.5	3.8	3.9	7.2	7.2
1985	Q1	<1>	7.4	6.7	3.1	1.3	3.1	3.7	3.7	5.1	7.3	7.3
	Q2		6.4	5.3	3.5	2.3	3.5	3.5	4.3	3.7	7.1	7.3
	Q3		6.5	6.3	3.3	3.5	3.5	3.3	3.8	3.6	6.9	7.2
	Q4		6.7	6.3	3.3	3.0	3.7	3.5	3.8	3.7	6.8	7.1
1986	Q1		6.2	6.5	2.4	2.6	3.9	3.8	4.1	4.0	6.8	7.0
	Q2		5.9	6.0	2.4	2.5	3.9	3.9	4.1	4.1	6.8	7.0
	Q3		6.6	6.3	2.8	2.5	4.1	4.1	4.4	4.4	6.7	7.0
	Q4		6.8	6.8	2.6	2.5	4.3	4.3	4.4	4.4	6.7	7.0
Two-quarter changes: <2>												
1984	Q2	<1>	12.8	12.8	8.6	8.6	4.2	4.2	4.4	4.4	-1.0	-1.0
	Q4	<1>	6.7	6.4	3.2	2.9	3.7	3.8	4.3	4.4	-3	-3
1985	Q2		6.9	6.0	3.3	1.8	3.3	3.6	4.0	4.4	-1	.1
	Q4		6.6	6.3	3.3	3.3	3.6	3.4	3.8	3.6	-3	-2
1986	Q2		6.0	6.3	2.4	2.6	3.9	3.8	4.1	4.1	.0	-1
	Q4		6.7	6.5	2.7	2.5	4.2	4.2	4.4	4.4	-1	.0
Four-quarter changes: <3>												
1983	Q4	<1>	10.4	10.4	6.3	6.3	3.7	3.7	4.4	4.4	-2.1	-2.1
1984	Q4	<1>	9.7	9.5	5.9	5.7	4.0	4.0	4.4	4.4	-1.3	-1.3
1985	Q4		6.8	6.1	3.3	2.5	3.4	3.5	3.9	4.0	-4	-1
1986	Q4		6.4	6.4	2.5	2.5	4.0	4.0	4.3	4.3	-1	-1

<1> Actual.

<2> Percent change from two quarters earlier.

<3> Percent change from four quarters earlier.

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

	1983				1984			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3173.8	3267.0	3346.6	3431.7	3553.3	3644.7	3694.6	3758.7
Gross domestic purchases	3154.2	3273.4	3363.0	3461.5	3604.8	3703.4	3785.2	3814.8
Final sales	3216.8	3286.4	3350.9	3419.0	3479.5	3594.1	3622.8	3722.1
Private	2538.0	2604.2	2661.1	2727.6	2775.1	2850.4	2861.8	2941.6
Domestic final purchases	2518.4	2610.7	2677.5	2757.4	2826.6	2909.1	2952.4	2997.6
Personal consumption expenditures	2070.4	2141.6	2181.4	2230.2	2276.5	2332.7	2361.4	2396.5
Goods	1034.6	1073.0	1095.8	1122.8	1152.2	1179.0	1178.6	1192.8
Services	1035.8	1068.6	1085.7	1107.5	1124.4	1153.7	1182.8	1203.8
Gross private domestic investment	405.0	449.6	491.9	540.0	623.8	627.0	662.8	637.8
Residential structures	113.3	129.8	142.3	143.4	151.2	155.6	155.3	153.5
Business fixed investment	334.6	339.3	353.9	383.9	398.8	420.8	435.7	447.7
Change in business inventories	-42.9	-19.4	-4.3	12.7	73.8	50.6	71.8	36.6
Nonfarm	-32.6	-5.4	11.6	14.1	60.6	47.0	63.7	27.2
Net exports of goods and services <1>	19.6	-6.5	-16.4	-29.8	-51.5	-58.7	-90.6	-56.0
Exports	328.5	328.1	342.0	346.1	358.9	362.4	368.6	367.2
Imports	308.9	334.5	358.4	375.9	410.4	421.1	459.3	423.2
Gov't. purchases of goods and services	678.8	682.2	689.8	691.4	704.4	743.7	761.0	780.5
Federal <2>	273.0	270.5	269.2	266.3	267.6	296.4	302.0	315.7
State and local	405.8	411.6	420.6	425.1	436.8	447.4	458.9	464.8
Gross national product in constant (1972) dollars	1491.0	1524.8	1550.2	1572.7	1610.9	1638.8	1645.2	1662.4
Personal income	2662.8	2714.4	2763.3	2836.5	2920.5	2984.6	3047.3	3096.2
Wage and salary disbursements	1608.1	1642.1	1671.3	1715.4	1755.7	1793.1	1819.5	1847.6
Disposable personal income	2261.4	2302.9	2367.4	2428.6	2502.2	2554.3	2606.4	2644.5
Saving rate (percent)	5.7	4.2	5.0	5.3	6.1	5.7	6.3	6.2
Corporate profits with I.V.A. and C.C. Adj.	179.1	216.7	245.0	260.0	277.4	291.1	282.8	291.6
Corporate profits before tax	161.7	198.2	227.4	225.5	243.3	246.0	224.8	228.7
Federal government surplus or deficit (-) (N.I.A. basis)	-185.7	-167.3	-180.9	-180.5	-161.3	-163.7	-180.6	-197.8
High employment surplus or deficit (-) <3>	-80.9	-74.2	-102.5	-113.1	-113.3	-129.6	-146.1	-169.3
State and local government surplus or deficit (-) (N.I.A. basis)	34.1	43.9	47.4	51.2	53.9	54.5	47.6	55.6
Excluding social insurance funds	-1.9	7.0	9.5	12.0	13.4	12.6	4.3	11.1
Civilian labor force (millions)	110.7	111.2	112.1	112.1	112.7	113.5	113.8	114.2
Unemployment rate (percent)	10.4	10.1	9.3	8.5	7.9	7.5	7.4	7.2
Nonfarm payroll employment	88.8	89.6	90.4	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	164.7
Capacity utilization: all manufacturing (percent)	70.7	73.8	77.4	78.9	80.7	81.8	82.5	81.6
Materials (percent)	70.1	73.5	77.5	79.6	81.6	82.7	82.9	80.7
Housing starts, private (million units, A.R.)	1.64	1.67	1.79	1.72	1.95	1.86	1.66	1.60
New auto sales (millions, A.R.)	8.46	9.10	9.22	9.94	10.52	10.60	10.30	10.29
Domestic models	6.06	6.81	6.92	7.29	8.22	8.23	7.94	7.50
Foreign models	2.40	2.29	2.31	2.65	2.30	2.38	2.36	2.79

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

<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.

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

	1983				1984			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	3.3	9.4	6.8	5.9	10.1	7.1	1.6	4.3
Gross domestic purchases	3.7	12.3	7.4	8.7	12.9	7.9	5.4	.9
Final sales	1.1	6.4	4.9	4.2	3.6	10.3	-1.0	7.9
Private	3.5	8.6	6.2	6.3	4.2	8.5	-2.4	8.4
Domestic final purchases	4.0	12.1	6.9	9.7	7.6	9.5	2.3	4.0
Personal consumption expenditures	2.6	10.0	3.8	6.8	4.6	7.9	.7	3.6
Goods	3.5	12.6	5.4	9.5	7.8	10.7	-1.9	3.8
Services	1.5	7.3	2.1	3.8	1.2	4.6	3.8	3.3
Gross private domestic investment	34.1	52.5	38.4	37.0	71.6	-2.2	24.9	-13.1
Residential structures	64.5	78.1	31.6	4.0	21.3	1.2	-4.6	-5.5
Business fixed investment	.0	9.6	18.7	30.6	20.6	21.3	13.7	8.5
Gov't. purchases of goods and services	-8.2	-2.6	-.5	-4.3	1.0	18.6	5.4	5.9
Federal	-17.4	-5.9	-5.3	-8.7	-2.8	45.2	6.2	15.2
National defense	6.8	7.6	-1.9	9.2	3.4	12.2	-2.3	17.5
State and local	-1.2	-.2	2.7	-1.4	3.5	3.7	4.8	-2.2
Disposable personal income	2.1	3.3	7.7	8.2	8.6	6.3	3.9	3.5
<u>Current Dollars</u>								
Gross national product	8.5	12.3	10.1	10.6	14.9	10.7	5.6	7.1
Gross domestic purchases	6.7	16.0	11.4	12.2	17.6	11.4	9.1	3.2
Final sales	5.9	8.9	8.1	8.4	7.3	13.8	3.2	11.4
Personal consumption expenditures	4.8	14.5	7.6	9.2	8.6	10.2	5.0	6.1
Goods	3.6	15.7	8.8	10.2	10.9	9.6	-.1	4.9
Services	6.1	13.3	6.6	8.3	6.2	10.9	10.5	7.3
Gross private domestic investment	34.3	52.0	43.2	45.3	78.0	2.0	24.9	-14.3
Residential structures	79.3	71.9	44.4	3.3	23.6	12.1	-.6	-4.7
Business fixed investment	-5.5	5.7	18.5	38.4	16.5	23.9	14.9	11.5
Gov't. purchases of goods and services	-1.3	2.0	4.5	.9	7.8	24.3	9.6	10.7
Federal	-8.9	-3.6	-2.0	-4.3	2.0	50.5	7.8	19.4
National defense	7.9	9.8	3.3	13.2	12.5	14.7	-.8	22.1
State and local	4.2	5.8	9.0	4.4	11.5	10.0	10.7	5.2
Disposable personal income	4.3	7.5	11.7	10.7	12.7	8.6	8.4	6.0
Personal income	3.6	8.0	7.3	11.0	12.4	9.1	8.6	6.7
Wage and salary disbursements	5.6	8.7	7.3	11.0	9.7	8.8	5.9	6.5
Corporate profits with I.F.A. and C.C.Adj.	94.8	114.3	63.4	26.8	29.6	21.3	-10.9	13.0
Corporate profits before tax	16.0	125.7	73.3	-3.3	35.5	4.5	-30.3	7.1
Nonfarm payroll employment	.5	3.4	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	1.1
Nonfarm business sector								
Output per hour	4.4	8.1	2.1	1.0	2.9	5.5	-1.1	2.2
Compensation per hour	5.7	3.5	2.2	4.1	6.1	3.7	3.6	3.7
Unit labor costs	1.3	-4.2	.1	3.0	3.1	-1.7	4.7	1.4
GNP implicit deflator <1>	5.0	2.6	3.1	4.4	4.4	3.3	3.9	2.8
Gross domestic business product								
fixed-weighted price index <2>	2.7	3.9	4.5	3.5	4.2	4.1	4.0	3.5
Excluding food and energy	4.9	3.5	5.4	3.8	3.4	5.4	4.9	3.9
Consumer price index (all urban)	.4	4.3	4.2	4.2	5.2	3.7	3.7	3.6
Industrial production	10.1	18.4	21.8	10.2	11.5	8.6	6.3	-2.3

<1> Excluding the federal pay increase, the rate of change in 1983-Q4 was 4.4 percent.

<2> Uses expenditures in 1972 as weights.

May 15, 1985

CONFIDENTIAL - FR
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							
	1985				1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3819.9	3869.7	3929.2	3989.4	4052.6	4112.5	4176.1	4245.0
Gross domestic purchases	3892.9	3942.0	4017.6	4083.2	4145.6	4206.6	4270.9	4337.7
Final sales	3773.3	3844.0	3893.3	3952.1	4018.0	4079.5	4143.8	4212.7
Private	2980.7	3031.0	3067.8	3112.5	3165.4	3215.6	3267.7	3322.9
Domestic final purchases	3053.7	3103.3	3156.1	3206.2	3258.4	3309.7	3362.5	3415.6
Personal consumption expenditures	2442.8	2479.1	2518.9	2557.2	2597.8	2637.5	2678.5	2719.6
Goods	1211.0	1226.0	1242.0	1257.5	1273.9	1289.3	1305.0	1320.3
Services	1231.8	1253.1	1276.9	1299.7	1323.9	1348.2	1373.4	1399.3
Gross private domestic investment	657.4	649.9	673.1	686.3	695.2	705.2	716.3	728.3
Residential structures	155.0	161.5	166.5	171.0	174.5	178.0	181.5	185.0
Business fixed investment	455.9	462.7	470.7	478.0	486.1	494.2	502.5	511.0
Change in business inventories	46.6	25.7	35.9	37.3	34.6	33.0	32.3	32.3
Nonfarm	40.5	23.4	34.3	37.3	34.6	33.0	32.3	32.3
Net exports of goods and services <1>	-73.0	-72.3	-88.3	-93.8	-93.0	-94.1	-94.8	-92.7
Exports	361.4	362.1	363.4	367.8	374.1	382.6	392.6	403.6
Imports	434.4	434.3	451.7	461.6	467.1	476.7	487.4	496.3
Gov't. purchases of goods and services	792.6	813.0	825.6	839.7	852.6	863.9	876.1	889.8
Federal <2>	320.2	331.6	335.9	341.7	346.8	350.3	354.7	360.2
State and local	472.5	481.4	489.7	498.0	505.8	513.6	521.4	529.6
Gross national product in constant (1972) dollars	1668.0	1677.5	1691.9	1704.6	1715.8	1726.3	1737.1	1747.8
Personal income	3141.6	3186.1	3242.2	3298.1	3350.0	3404.1	3457.5	3514.1
Wage and salary disbursements	1882.6	1910.8	1943.0	1973.5	2005.8	2035.7	2064.7	2095.3
Disposable personal income	2652.6	2734.4	2763.5	2806.7	2859.0	2901.5	2943.6	2988.4
Saving rate (percent)	4.6	6.0	5.5	5.5	5.7	5.6	5.5	5.5
Corporate profits with I.V.A. and C.C. Adj.	298.1	296.9	296.3	293.8	292.1	292.9	296.4	299.7
Corporate profits before tax	227.7	223.9	220.3	214.8	209.1	206.9	208.4	209.7
Federal government surplus or deficit (-) (N.I.A. basis)	-161.2	-217.5	-198.9	-193.8	-192.2	-191.4	-190.9	-190.3
High employment surplus or deficit (-) <3>	-128.3	-185.2	-168.7	-165.0	-163.3	-162.1	-161.0	-159.5
State and local government surplus or deficit(-) (N.I.A. basis)	56.4	56.7	54.8	50.9	49.8	49.7	50.5	51.2
Excluding social insurance funds	11.0	10.5	7.8	3.1	1.2	.3	.3	.2
Civilian labor force (millions)	115.2	115.5	115.9	116.3	116.8	117.2	117.7	118.2
Unemployment rate (percent)	7.3	7.3	7.2	7.1	7.0	7.0	7.0	7.0
Nonfarm payroll employment	96.2	96.9	97.5	98.1	98.6	99.1	99.6	100.0
Manufacturing	19.8	19.7	19.8	19.8	19.9	19.9	20.0	20.0
Industrial production (1967=100)	165.4	165.8	166.9	168.2	169.4	170.7	171.9	173.1
Capacity utilization: all manufacturing (percent)	81.0	80.5	80.4	80.3	80.3	80.2	80.2	80.2
Materials (percent)	80.7	80.3	80.3	80.2	80.1	80.1	80.1	80.0
Housing starts, private (million units, A.R.)	1.79	1.80	1.80	1.80	1.80	1.85	1.85	1.85
New auto sales (millions, A.R.)	10.87	10.90	11.00	10.90	10.90	10.80	10.80	10.70
Domestic models	8.46	8.30	8.10	7.90	7.90	7.80	7.70	7.60
Foreign models	2.42	2.60	2.90	3.00	3.00	3.00	3.10	3.10

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

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

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

CONFIDENTIAL - FR
CLASS II FOMC

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

	1985				Projected			
					1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	1.3	2.3	3.5	3.0	2.6	2.5	2.5	2.5
Gross domestic purchases	4.4	1.5	4.2	3.3	2.5	2.2	2.2	2.1
Final sales	.4	4.7	2.5	3.0	3.0	2.7	2.7	2.5
Private	.5	4.5	2.5	3.0	3.2	3.0	2.8	2.7
Domestic final purchases	4.3	3.4	3.4	3.2	3.0	2.6	2.4	2.2
Personal consumption expenditures	4.7	2.6	2.8	2.7	2.6	2.2	2.0	1.8
Goods	5.1	2.7	3.0	2.9	2.8	2.2	1.9	1.7
Services	4.4	2.3	2.6	2.4	2.4	2.2	2.1	2.0
Gross private domestic investment	7.9	-6.2	11.7	5.4	2.4	2.7	3.2	3.5
Residential structures	-8	14.3	8.9	7.7	4.5	4.3	3.9	3.7
Business fixed investment	3.5	5.2	5.0	4.7	4.4	4.0	4.0	3.9
Gov't. purchases of goods and services	.2	5.3	2.2	3.2	2.0	1.7	1.8	1.8
Federal	-8	8.8	2.0	4.2	2.1	1.3	1.7	1.4
National defense	-2.4	18.0	3.4	3.8	1.2	1.2	2.5	4.1
State and local	.9	2.8	2.4	2.4	2.0	2.0	1.9	2.0
Disposable personal income	-1.8	9.2	.6	2.9	3.7	2.0	1.6	1.7
<u>Current Dollars</u>								
Gross national product	6.7	5.3	6.3	6.3	6.5	6.0	6.3	6.8
Gross domestic purchases	8.4	5.1	7.9	6.7	6.3	6.0	6.3	6.4
Final sales	5.6	7.7	5.2	6.2	6.8	6.3	6.5	6.8
Personal consumption expenditures	8.0	6.1	6.6	6.2	6.5	6.3	6.4	6.3
Goods	6.2	5.0	5.3	5.1	5.3	4.9	5.0	4.8
Services	9.6	7.1	7.8	7.3	7.7	7.5	7.7	7.7
Gross private domestic investment	12.9	-4.5	15.1	8.1	5.3	5.8	6.5	6.8
Residential structures	3.9	17.9	13.0	11.3	8.4	8.3	8.1	7.9
Business fixed investment	7.5	6.1	7.1	6.4	7.0	6.8	7.0	6.9
Gov't. purchases of goods and services	6.4	10.7	6.3	7.0	6.3	5.4	5.8	6.4
Federal	5.8	15.0	5.3	7.1	6.1	4.2	5.1	6.3
National defense	5.0	22.3	7.0	7.0	5.8	4.8	6.5	8.0
State and local	6.7	7.7	7.1	7.0	6.4	6.3	6.2	6.4
Disposable personal income	1.2	12.9	4.3	6.4	7.7	6.1	5.9	6.2
Personal income	6.0	5.8	7.2	7.1	6.4	6.6	6.4	6.7
Wage and salary disbursements	7.8	6.1	6.9	6.4	6.7	6.1	5.8	6.1
Corporate profits with I.V.A. and C.C.Adj.	9.2	-1.6	-8	-3.4	-2.3	1.1	4.9	4.6
Corporate profits before tax	-1.7	-6.5	-6.3	-9.6	-10.2	-4.1	2.9	2.5
Nonfarm payroll employment	3.4	2.9	2.3	2.5	2.1	1.9	1.9	1.7
Manufacturing	.4	-2.0	2.1	1.6	1.2	1.0	1.0	1.0
Nonfarm business sector								
Output per hour	-1.2	.2	1.5	1.2	.9	.8	.9	1.2
Compensation per hour	6.0	4.2	4.3	4.3	4.8	4.4	4.5	4.6
Unit labor costs	7.3	4.0	2.8	3.1	3.9	3.6	3.6	3.4
GNP implicit deflator <1>	5.3	2.9	2.7	3.1	3.7	3.3	3.7	4.2
Gross domestic business product								
fixed-weighted price index <2>	3.7	3.5	3.3	3.5	3.8	3.9	4.1	4.3
Excluding food and energy	5.1	3.7	3.6	3.7	4.0	4.1	4.4	4.4
Consumer price index (all urban)	3.2	4.1	3.4	3.7	4.0	4.0	4.2	4.4
Industrial production	1.8	.9	2.8	3.2	2.9	2.9	3.0	2.8

<1> Excluding Federal pay increase, the rate of change in 1985-Q1 is 4.9 percent and in 1986-Q1 is 3.6 percent.
<2> Uses expenditures in 1972 as weights.

May 15, 1985

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CLASS II FOMCGROSS 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	2957.8	3069.3	3304.8	3662.8	3902.1	4146.5
Gross domestic purchases	2404.5	2607.7	2929.8	3050.2	3313.0	3727.1	3983.9	4240.2
Final sales	2403.5	2641.5	2931.7	3095.4	3318.3	3604.6	3865.7	4113.5
Private	1929.2	2103.7	2335.2	2444.9	2632.8	2857.2	3048.0	3242.9
Domestic final purchases	1915.9	2079.7	2307.2	2425.9	2641.1	2921.4	3129.8	3336.5
Personal consumption expenditures	1507.2	1668.1	1849.1	1984.9	2155.9	2341.8	2499.5	2658.3
Goods	813.4	883.5	966.1	1002.6	1081.5	1175.7	1234.1	1297.1
Services	693.7	784.5	883.0	982.2	1074.4	1166.1	1265.4	1361.2
Gross private domestic investment	423.0	401.9	484.2	414.9	471.6	637.8	666.7	711.3
Residential construction	118.6	102.9	104.3	91.4	132.2	153.9	163.5	179.7
Business fixed investment	290.2	308.8	353.9	349.6	352.9	425.7	466.8	498.5
Change in business inventories	14.3	-9.8	26.1	-26.1	-13.5	58.2	36.4	33.1
Nonfarm	8.6	-4.5	18.2	-24.0	-3.1	49.6	33.9	33.1
Net exports of goods and services <1>	13.2	24.0	28.0	19.0	-8.3	-64.2	-81.8	-93.7
Exports	281.3	338.8	369.9	348.4	336.2	364.3	363.7	388.2
Imports	268.1	314.8	341.9	329.4	344.4	428.5	445.5	481.9
Gov't. purchases of goods and services	474.4	537.8	596.5	650.5	685.5	747.4	817.7	870.6
Federal <2>	168.3	197.1	228.9	259.0	269.7	295.4	332.3	353.0
State and local	306.0	340.8	367.6	391.5	415.8	452.0	485.4	517.6
Gross national product in constant (1972) dollars	1479.4	1475.0	1512.2	1480.0	1534.7	1639.3	1685.5	1731.7
Personal income	1951.2	2165.3	2429.5	2584.6	2744.2	3012.1	3217.0	3431.4
Wage and salary disbursements	1237.6	1356.7	1493.1	1568.7	1659.2	1804.0	1927.5	2050.3
Disposable personal income	1650.2	1828.9	2041.7	2180.5	2340.1	2576.8	2739.3	2923.1
Saving rate (percent)	5.9	6.0	6.7	6.2	5.0	6.1	5.4	5.6
Corporate profits with I.V.A. and C.C.Adj.	194.8	175.4	189.9	159.1	225.2	285.7	296.3	295.3
Corporate profits before tax	252.7	234.6	221.2	165.5	203.2	235.7	221.7	208.5
Federal government surplus or deficit (-) (N.I.A. basis)	-16.1	-61.3	-64.3	-148.2	-178.6	-175.8	-192.8	-191.2
High employment surplus or deficit (-)	-20.8	-36.4	-31.3	-61.6	-92.7	-139.6	-161.8	-161.5
State and local government surplus or deficit (-) (N.I.A. basis)	30.4	30.6	37.6	32.9	44.1	52.9	54.7	50.3
Excluding social insurance funds	6.6	3.5	7.8	-8	6.6	10.4	8.1	.5
Civilian labor force (millions)	103.0	106.9	108.7	110.2	111.6	113.5	115.7	117.5
Unemployment rate (percent)	5.8	7.1	7.6	9.7	9.6	7.5	7.2	7.0
Nonfarm payroll employment (millions)	89.8	90.4	91.2	89.6	90.1	94.2	97.2	99.3
Manufacturing	21.0	20.3	20.2	18.8	18.5	19.6	19.8	20.0
Industrial production (1967=100)	152.5	147.0	150.9	138.6	147.6	163.3	166.6	171.3
Capacity utilization, all manufacturing (percent)	86.8	79.6	79.4	71.1	75.2	81.6	80.6	80.2
Materials (percent)	87.6	80.4	80.7	70.1	75.2	82.0	80.3	80.1
Housing starts, private (million units, A.R.)	1.72	1.38	1.10	1.04	1.70	1.77	1.80	1.84
New auto sales (millions, A.R.)	10.68	9.04	8.96	8.00	9.18	10.43	10.91	10.80
Domestic models	8.36	6.62	6.26	5.77	6.77	7.97	8.19	7.75
Foreign models	2.32	2.42	2.70	2.23	2.41	2.46	2.72	3.05

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

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

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

	1979	1980	1981	1982	1983	1984	—Projected—	
							1985	1986
<u>Constant (1972) Dollars</u>								
Gross national product	2.8	-.3	2.5	-2.1	3.7	6.8	2.8	2.7
Gross domestic purchases	2.0	-1.2	3.1	-1.2	4.9	8.7	3.4	2.7
Final sales	3.5	.5	1.5	-.7	3.2	5.0	3.4	2.9
Private	4.0	.1	1.6	-1.3	4.1	5.3	3.2	3.0
Domestic final purchases	2.9	-1.0	2.2	-.2	5.6	7.6	4.0	2.9
Personal consumption expenditures	2.7	.5	2.0	1.3	4.8	5.3	3.4	2.4
Goods	1.9	-1.4	1.7	.4	6.0	7.1	3.4	2.5
Services	3.7	2.7	2.3	2.5	3.4	3.2	3.4	2.3
Gross private domestic investment	-.2	-11.8	10.7	-15.9	13.7	31.2	2.5	3.7
Residential structures	-5.3	-20.3	-5.5	-14.8	41.7	12.2	2.3	6.0
Business fixed investment	7.3	-2.4	5.5	-4.6	2.5	19.8	7.2	4.4
Gov't. purchases of goods and services	1.3	2.2	.9	2.0	-.3	3.5	4.3	2.4
Federal	1.8	4.2	3.7	6.1	-.6	5.4	7.8	2.6
National defense	2.6	3.9	5.0	7.6	7.1	5.8	6.8	3.3
State and local	1.1	1.0	-.6	-.6	.0	2.2	2.0	2.2
Disposable personal income	2.7	.6	2.7	.9	3.5	6.7	3.0	2.8
<u>Current Dollars</u>								
Gross national product	11.7	8.8	12.4	3.8	7.7	10.8	6.5	6.3
Gross domestic purchases	11.1	8.5	12.3	4.1	8.6	12.5	6.9	6.4
Final sales	12.4	9.9	11.0	5.6	7.2	8.6	7.2	6.4
Personal consumption expenditures	11.9	10.7	10.9	7.3	8.6	8.6	6.7	6.4
Goods	11.7	8.6	9.3	3.8	7.9	8.7	5.0	5.1
Services	12.2	13.1	12.6	11.2	9.4	8.5	8.5	7.6
Gross private domestic investment	9.4	-5.0	20.5	-14.3	13.7	35.2	4.5	6.7
Residential structures	6.6	-13.2	1.3	-12.4	44.7	16.4	6.2	9.9
Business fixed investment	16.6	6.4	14.6	-1.2	.9	20.6	9.6	6.8
Gov't. purchases of goods and services	9.8	13.4	10.9	9.0	5.4	9.0	9.4	6.5
Federal	9.6	17.1	16.2	13.1	4.2	9.5	12.5	6.2
National defense	11.5	17.3	17.2	16.8	11.7	10.5	11.4	7.1
State and local	9.9	11.4	7.9	6.5	6.2	8.7	7.4	6.6
Disposable personal income	12.0	10.8	11.6	6.8	7.3	10.1	6.3	6.7
Personal income	12.6	11.0	12.2	6.4	6.2	9.8	6.8	6.7
Wage and salary disbursements	11.9	9.6	10.1	5.1	5.8	8.7	6.9	6.4
Corporate profits with I.V.A. and C.C.Adj.	1.2	-9.9	8.3	-16.2	41.5	27.0	3.6	-.3
Corporate profits before tax	10.3	-7.1	-5.7	-25.2	22.8	16.1	-6.0	-5.9
Nonfarm payroll employment	3.6	.6	.8	-1.7	.6	4.5	3.2	2.2
Manufacturing	2.6	-3.6	-.6	-6.9	-1.5	5.9	.8	1.1
Nonfarm business sector								
Output per hour	-1.5	-.7	1.5	.2	3.5	2.7	.6	1.0
Compensation per hour	9.0	10.3	9.6	8.0	4.9	4.1	4.5	4.5
Unit labor costs	10.7	11.1	8.0	7.7	1.4	1.4	3.9	3.5
GNP implicit deflator	8.6	9.2	9.6	6.0	3.8	3.7	3.6	3.4
Gross domestic business product								
fixed-weighted price index <1>	9.9	10.0	9.6	6.0	3.8	4.0	3.7	3.7
Excluding food and energy	8.6	8.5	9.4	7.0	4.6	4.3	4.3	4.0
Consumer price index (all urban)	11.3	13.5	10.3	6.1	3.2	4.3	3.6	3.9
Industrial production	4.4	-3.6	2.6	-8.1	6.4	10.7	2.0	2.8

<1> Uses expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS
(Billions of dollars)

	Fiscal Year 1984*	FY1985 ^a /2/		FY1986 ^a /2/		CY 1984*	CY1985 ^a FRB Staff	FRB staff estimates Calendar quarters; not seasonally adjusted								
		Admin. 1/	FRB Staff	Admin. 1/	FRB Staff			1984			1985			1986		
								IV ^a	I ^a	II	III	IV	I	II	III	
Unified budget receipts	666	741	733	794	787	683	742	166	174	206	187	174	185	230	198	
Unified budget outlays	842	944	939	971	972	867	947	239	230	235	236	247	241	242	242	
Surplus/deficit(-), unified budget	-175	-203	-206	-177	-185	-184	-205	-73	-56	-29	-49	-73	-56	-12	-44	
Surplus/deficit(-), off-budget agencies ³	-10	-10	-10	-1	-5	-10	-12	1	-3	-4	-4	-1	-1	-2	-1	
Combined deficit to be financed	-185	-213	-216	-177	-190	-195	-217	-72	-59	-33	-53	-74	-57	-14	-45	
Means of financing combined deficit:																
Net borrowing from public	171	201	197	179	185	199	198	64	42	38	54	65	54	13	52	
Decreases in cash operating balance	7	10	10	0	0	-5	8	13	4	-5	-1	10	-5	0	-5	
Other ⁴	8	2	9	-1	5	2	12	-6	13	1	0	-2	8	1	-2	
Cash operating balance, end of period	30	30	20	20	20	18	10	18	14	19	20	10	15	15	20	
Memo: Sponsored agency borrowing ⁵	30	42	16	46	20	32	18	3	4	4	5	5	5	5	5	
NIA Budget								Seasonally adjusted annual rates								
Receipts	688	762	751	825	806	705	767	722	774	740	769	785	799	813	828	
Expenditures	860	945	945	990	999	881	960	920	935	957	968	979	991	1005	1019	
Purchases	283	327	326	355	348	295	332	316	320	332	336	342	347	350	355	
Defense	215	242	241	272	260	222	247	232	235	247	251	255	259	262	266	
Nondefense	68	85	85	83	88	74	86	84	86	85	85	87	88	89	89	
All other expenditures	577	618	619	635	651	586	628	604	615	625	632	637	644	655	664	
Surplus/deficit(-)	-172	-183	-194	-165	-193	-176	-193	-198	-161	-217	-199	-194	-192	-191	-191	
High employment surplus/deficit(-) evaluated at 6 percent unemployment	-126	n.a.	-163	n.a.	-163	-140	-162	-169	-128	-185	-168	-165	-163	-162	-161	
	*--actual						e--estimated	n.a.--not available								

1. O.N.B., Current Budget Estimates (April 1985) and B.E.A. translations to an NIA basis.
2. The GBO 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. Most market interest rates have fallen during the intermeeting period by 5/8 to slightly more than a full percentage point. The federal funds rate has eased somewhat, but the rally has been given additional impetus by market participants' perceptions that an easing of reserve conditions by the Federal Reserve might be in process in light of weaker economic and monetary growth. Most recently, progress on deficit-reduction measures has contributed to lower rates. New commitment rates for conventional fixed-rate home mortgages have declined only 1/4 percentage point, while the prime rate is unchanged. The recent failure of some small government securities dealers and the difficulties experienced by privately insured thrift institutions have not led to significant changes in risk spreads between interest rates, and there is no evidence that financial institutions' problems are having broader impacts on credit supplies.

The monetary aggregates slowed sharply in March and April, leaving M1 just above the top of its parallel band and the broader aggregates within their cones. The deceleration in all of the aggregates to an extent reflected the waning influence of the earlier declines in interest rates. The timing of tax refunds and payments appears to have had little net effect on M1 growth. M2 was depressed in April by a substantial drop in overnight RPs, as banks reduced their holdings of Treasury securities and some overnight RPs were classified as term agreements over the Easter weekend. In addition, the broader aggregates might have been restrained in April by the failure of seasonal factors to account adequately for flows into IRA/Keogh deposits. Issuance of large CDs by commercial banks surged in March but fell back a bit in April, paralleling the pattern of bank credit expansion.

However, large CDs at thrift institutions have been quite weak, evidently reflecting slower asset growth at savings and loans. S&Ls apparently have been bidding less aggressively for both retail and wholesale funds in the past few months, perhaps influenced by constraints on asset expansion imposed by FHLBB net worth standards.

The growth of domestic nonfinancial sector debt during the first four months of 1985 appears to have remained robust, but a bit below last year's pace. Despite an estimated widening of the financing gap and continued strong merger activity, overall business borrowing evidently has fallen off a bit. The sum of business loans and nonfinancial commercial paper has been growing at a moderate pace in recent months, and in light of favorable conditions in long-term markets, bond issuance has been strong. Stock prices have remained near their peaks since the last FOMC meeting, and issuance of new equity shares has picked up appreciably; however, retirements of equity have continued massive, swamping new issues.

Borrowing by state and local governments has been strong. Offerings of long-term tax-exempt securities have grown, with volume in the past month or so boosted by increased issuance of refunding bonds as market yields dropped considerably. Despite a large inflow of federal tax receipts, Treasury borrowing remained substantial in April, temporarily swelling the Treasury's cash balance at the end of that month to \$40 billion. Borrowing by the federally sponsored credit agencies has been moderate this year, with FNMA and FHLMC accounting for most of the activity. The Farm Credit Banks have paid down securities, as farm debt extensions continue weak owing to depressed agricultural conditions.

Total residential mortgage growth remained vigorous in the first quarter. Mortgage lending at thrift institutions, however, was comparatively sluggish, and commitment activity was off. The sponsored housing agencies have met some of the demand for mortgage funds through portfolio purchases, and issuance of federally guaranteed mortgage pass-through certificates also picked up in the first quarter.

Consumer installment debt continued to swell at a remarkable pace in March and there is no real indication of a slowing in April. Some households that experienced delays in receiving their federal income tax refunds may have used consumer credit to make purchases, but this would seem only a partial explanation for the persistent strength of installment credit. Although delinquency rates on consumer loans appear to have edged upward in the past couple of quarters, they remain historically low and creditors still appear more than willing to lend, given the attractive interest margins.

Outlook. It is expected that overall credit growth will remain brisk in the next several months as the economy continues to expand, although the composition of flows may change somewhat. Absent an unanticipated weakening in economic or monetary growth, short-term interest rates are unlikely to drop appreciably further. Long-term rates could decline further, however, if a convincing deficit-reduction program is approved by Congress.

The gap between business capital expenditures and internal funds may be narrowed in the near term by slower inventory accumulation, but with continued heavy retirements of equity shares, business borrowing probably will remain robust. Firms likely will continue to emphasize longer-term sources of funds. However, short-term borrowing will be necessary as well,

and bank business loan growth is projected to rebound from the weak April rate to the moderate pace observed since the middle of last year.

Borrowing by state and local governments is expected to moderate somewhat in coming quarters, although likely buoyed for a while longer by refunding issues. Treasury borrowing will be somewhat lighter in the second quarter, owing to the seasonal bulge in receipts. More fundamentally, though, the trajectory of the budget deficit implies that pressures on credit markets from the federal sector will continue unabated in the months ahead.

The rate of household borrowing is expected to edge down. Some further slowing in the growth of demand for durable goods and mounting repayments on indebtedness both are expected to exert some moderating influence on consumer credit. Home mortgage flows are likely to be sustained by robust home building and sales activity. If investors' concerns about the soundness of thrift institutions were to escalate, the ability of these institutions to finance additional mortgage assets could be curtailed, but the capacity of debt markets to absorb mortgage-related securities appears adequate to meet the residual demand for funds without much upward pressure on mortgage rates.

INTERNATIONAL DEVELOPMENTS

Recent developments. The weighted-average foreign exchange value of the dollar has exhibited wide swings since the last FOMC meeting, depreciating 5 percent on balance to a current level about 10 percent below its late-February peak. The primary apparent influences on exchange rate movements over the period were revisions in perceptions about the strength of U.S. economic activity, about the stability of certain U.S. financial institutions, and about the responses of monetary policy and dollar interest rates.

Following a period of weakness earlier in the year, the pound has appreciated almost 7 percent against the dollar since the last FOMC meeting. The 3-month sterling interbank rate has declined about 1-3/4 percentage points from its late January peak, but remains about 2-1/2 percentage points above its level prior to the sharp rate hikes in mid-January.

, available data on U.S. international capital account transactions during the first quarter indicate that official reserve assets in the United States declined by \$5-1/2 billion for the G-10

countries and nearly \$11 billion for all foreign countries. Private foreign net purchases of U.S. Treasury obligations declined considerably to less than \$3 billion in the first quarter, while private foreign net purchases of U.S. corporate securities matched the fourth-quarter inflow of more than \$10 billion. Transactions reported by U.S. banking offices shifted to a massive first-quarter net inflow of nearly \$18 billion; half of that net inflow, however, reversed a net outflow to own foreign offices on the final day of 1984, apparently for purposes of window dressing.

The U.S. merchandise trade deficit rose in the first quarter after dropping sharply in the fourth quarter. The value of exports was essentially unchanged from the fourth quarter, as agricultural exports declined and nonagricultural exports increased somewhat. The value of oil imports declined about 25 percent in the first quarter, partly reflecting lower prices, but mainly reflecting a lower import volume as domestic oil consumption declined slightly and inventories were drawn down. Meanwhile, nonoil imports rebounded sharply in volume, continuing a pattern of large erratic fluctuations that began in the first quarter of 1984.

In most major foreign industrial countries, economic activity appears to have weakened during the early months of the year. In Germany, severe weather contributed to a decline in industrial production. Industrial production also contracted in Japan and Canada, although other indicators of activity suggest continued first-quarter growth. Unemployment rates have recently increased in the European countries and declined somewhat in Canada and Japan. Inflation in the

foreign industrial countries generally remains low; in some, however, domestic prices have accelerated during early 1985 in association with increases in import prices. In particular, German consumer prices rose at an annual rate of 5 percent in the first four months of the year (n.s.a.), compared with 3 percent in the final quarter of 1984.

In the non-OPEC developing countries, economic activity rebounded at about a 4 percent average growth rate in 1984 following the recession of 1982-83. The combined current account deficit of these countries declined by \$45 billion during 1983-84, but the trade surpluses of Mexico and Brazil so far in 1985 are running somewhat lower than in 1984. Progress toward debt reschedulings has been mixed. The initial signing of the multi-year commercial bank rescheduling for Mexico took place on March 29, after Mexico reached agreement with the IMF management on the country's economic policies for 1985. Preliminary reschedulings and trade credit arrangements between commercial banks and the authorities in Brazil and Argentina hinge on the outcome of negotiations with the IMF over new economic stabilization programs. Argentina's inflation increased to a 30 percent monthly rate in April, but some significant tightening of monetary policy occurred in late April and early May.

Claims of BIS-reporting banks on external borrowers increased by \$126 billion (or about 6 percent) in 1984, compared with a \$105 billion increase in 1983. Claims on non-OPEC developing countries increased by \$9 billion (about 2-3/4 percent), compared with \$12 billion (nearly 4 percent) in 1983.

Outlook. The staff continues to project a moderate depreciation of the dollar throughout the forecast period, though from a lower starting point than in the last Greenbook. The projection for economic activity in the major foreign industrial countries is little changed, with GNP growth at about 3 percent in 1985 and slightly weaker in 1986. Inflation rates in the major foreign industrial countries are expected to average roughly 4 percent in both years. Against this background, the staff's projection for the US current account deficit is around \$120 billion for 1985 and \$135 billion for 1986, compared with a recorded deficit of \$102 billion in 1984.

MAY 14, 1985

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

	ANNUAL			1984		1985				1986			
	1984-	1985-P	1986-P	Q3-	Q4-	Q1-	Q2-P	Q3-P	Q4-P	Q1-P	Q2-P	Q3-P	Q4-P
1. GNP EXPORTS AND IMPORTS 1/													
CURRENT \$, NET	-64.2	-81.8	-93.7	-90.6	-56.0	-73.0	-72.3	-88.3	-93.8	-93.0	-94.1	-94.8	-92.7
EXPORTS OF G+S	364.3	363.7	388.2	368.6	367.2	361.4	362.1	363.4	367.8	374.1	382.6	392.6	403.6
IMPORTS OF G+S	428.5	445.5	481.9	459.3	423.2	434.4	434.3	451.7	461.6	467.1	476.7	487.4	496.3
CONSTANT 72 \$, NET	-15.0	-25.4	-24.5	-27.0	-13.4	-26.1	-22.7	-25.8	-26.9	-26.3	-25.3	-24.0	-22.4
EXPORTS OF G+S	146.0	144.3	148.5	147.4	147.1	144.0	144.3	144.1	144.8	145.6	147.3	149.5	151.7
IMPORTS OF G+S	161.1	169.7	173.0	174.4	160.5	170.1	167.0	169.9	171.7	172.0	172.6	173.5	174.0
2. U.S. MERCHANDISE TRADE BALANCE 2/	-107.4	-122.0	-135.8	-129.6	-97.6	-113.3	-113.0	-128.1	-133.7	-133.7	-135.9	-138.0	-135.8
EXPORTS	220.3	224.8	238.7	222.2	225.4	224.3	224.3	224.5	226.0	229.7	234.9	240.9	249.3
AGRICULTURAL	38.4	33.6	35.8	36.9	38.3	34.1	33.7	33.2	33.3	34.2	35.5	36.2	37.3
NONAGRICULTURAL	181.9	191.2	202.9	185.4	187.1	190.2	190.7	191.3	192.7	195.5	199.3	204.7	212.1
IMPORTS	327.8	346.8	374.5	351.9	323.0	337.6	337.3	352.6	359.7	363.4	370.7	378.9	385.1
PETROLEUM AND PRODUCTS	57.3	49.8	49.9	57.8	56.4	42.3	50.4	54.5	52.2	48.2	49.3	51.1	51.1
NONPETROLEUM	270.5	297.0	324.6	294.0	266.6	295.3	287.0	298.1	307.5	315.2	321.5	327.8	334.0
3. U.S. CURRENT ACCOUNT BALANCE	-101.7	-120.0	-134.1	-132.3	-100.8	-109.5 ^P	-109.1	-126.5	-134.9	-131.1	-133.6	-135.6	-136.0
OF WHICH: NET INVESTMENT INCOME	18.1	17.1	15.7	11.5	16.2	17.8 ^P	17.7	16.7	16.4	15.8	15.8	16.1	14.9
4. FOREIGN OUTLOOK 3/													
REAL GNP--TEN INDUSTRIAL 4/	3.0	3.1	2.8	4.0	4.2	2.9 ^P	2.9	2.8	3.1	3.1	2.6	2.4	2.7
REAL GNP--NONOPEC LDC 5/	4.1	4.0	4.1	4.4	4.1	3.7 ^P	3.7	3.8	3.9	4.0	4.3	4.6	4.9
CONSUMER PRICES--TEN IND. 4/	4.9	4.2	3.9	2.6	4.9	5.0 ^P	4.2	3.1	3.9	4.3	3.8	3.6	3.7

/ ECONOMIC ACTIVITY AND PRODUCT ACCOUNT DATA.
/ INTERNATIONAL ACCOUNTS BASIS.
/ PERCENT CHANGE, ANNUAL RATES.
/ WEIGHTED BY MULTILATERAL TRADE-WEIGHTS OF G-10 COUNTRIES PLUS SWITZERLAND; PRICES ARE NOT SEASONALLY ADJUSTED.
/ WEIGHTED BY SHARE IN NONOPEC LDC GNP.
/ PROJECTED