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December 11, 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. Economic activity appears, in the aggregate, to have expanded at a moderate rate in recent months. Consumer and producer prices were boosted in October by developments in markets for autos and food, but underlying trends in inflation appear little changed.

Growth in nonfarm payroll employment slowed in November after surging the previous month; the average increase over the two-month period was 270,000, about equal to the average monthly change in the third quarter. Much of the strength continues to be in services industries, which accounted for more than one-third of the gain in payroll jobs since August. However, after contracting during the preceding three quarters, manufacturing employment rose substantially in October and edged up further in November (after adjusting for strikes). In addition, the factory workweek remains high. Early indications are that industrial production posted a moderate gain in November.

Production of new domestic automobiles was at a 7.8 million unit annual rate in November, a bit higher than in October. Assemblies have been running well ahead of the 6.3 to 6.4 million unit selling rate that has prevailed since the end in September of special financing programs for 1985 models. As a result, substantial inventories accumulated at dealers by the end of November, and manufacturers recently reintroduced special low-rate financing on a selective basis.

The decline in auto sales from an 11-1/4 million unit rate in September to a 6-1/4 million unit rate in October more than accounted for a decline of 1 percent (not annual rate) in personal consumption expenditures. Excluding autos, the rise in consumer outlays outpaced the moderate growth in income. Income growth has been slow this year, and the saving rate has fallen to a historically low level. Nevertheless, consumer surveys in November continued to report relatively favorable attitudes by households toward their personal finances and spending.

Business investment spending, in the aggregate, appears to have remained sluggish in recent months. Shipments of nondefense capital goods in October increased 4-1/2 percent to a level 2-3/4 percent above the third-quarter average, with gains widespread by type of equipment. But sales of motor vehicles to businesses--both cars and trucks--were down sharply. Moreover, outlays for nonresidential structures were little changed in October after a flat third quarter. New orders for nondefense capital goods continue to show no trend, suggesting little growth in equipment purchases in the near term. Moreover, the leveling off of permits for nonresidential building this year points to a slowdown as 1986 progresses.

The rise in shipments of nondefense capital goods in October apparently contributed to a sharp \$23-1/2 billion drawdown in manufacturers' inventories. More generally, with orders sluggish and inflation still low, manufacturers are maintaining a cautious inventory policy. Excluding autos, retailers have been stocking at a moderate rate, although general merchandisers and apparel outlets did show relatively sizable accumulations in August and September.

Homebuilding picked up in October as total private housing starts rose to a 1-3/4 million unit annual rate. The improvement was concentrated in single-family units, which reached their highest level since April. On the demand side, existing home sales in October were substantially above their third-quarter average; new home sales, however, posted a disappointing drop. In the market for multifamily units, starts also edged up, but remained at the somewhat reduced third-quarter pace.

Defense spending, which contributed importantly to the third-quarter burst of federal purchases, remained at a high level in October. Available indicators suggest that a high level of outlays is likely to be maintained in the near term. For example, unfilled orders for defense equipment continue to trend up, and unspent balances from the successively higher appropriations approved in recent years continue to mount.

Compensation per hour in the nonfarm business sector increased at a 3-3/4 percent annual rate in the third quarter, and so far this year is running just below the 1984 pace. Productivity bounced back at a 2.1 percent annual rate last quarter with the sharp pickup in output growth. This increase follows a period of sluggish productivity performance in late 1984 and early 1985 when the sharp slowing of output growth was not matched by deceleration in hours worked. Over the past five quarters, output per hour has been flat, on average, after a cyclical rise of more than 4 percent at an annual rate during the first year and a half of the recovery.

Price increases in October were larger than in recent months, reflecting developments in the markets for autos and crude foods. The consumer price index rose 0.3 percent, a bit above the pace that prevailed

from May to September; the producer price index increased 0.9 percent in October, retracing the declines in August and September. Both measures reflect the combined effect of higher prices for 1986 cars and the ending of financing incentives. At both the producer and consumer levels, a tightening of supplies led to a rebound in meat prices, although the CPI showed some offsetting declines in other categories of retail food.

Outlook. The staff expects that real GNP will rise at around a 2-1/2 percent annual rate in the current quarter. The sharp dropoff in auto sales between the third and fourth quarters is likely to keep overall consumer and business spending little changed. However, auto production is expected to average close to the third-quarter level, leading to a substantial rise in dealer inventories. Thus, on net, the auto sector should have little effect on real GNP growth. Apart from autos, moderate growth is anticipated in spending for other types of consumer goods and capital equipment. With housing starts rising, residential construction will continue to contribute to growth, and some improvement in export demand is expected. Except for autos, inventory investment is projected to be minimal. Inflation, as measured by the gross domestic business product fixed-weighted price index, is anticipated to be at a 3-1/2 percent annual rate this quarter--about the same as the average over the first three quarters of the year. Prices for consumer foods are likely to accelerate, but energy prices are expected to be down again in the fourth quarter. Inflation for other goods and services is anticipated to be little changed from the average earlier in the year.

The fiscal policy assumptions underlying the staff projection for 1986 have been altered to reflect initiatives by Congress to limit the size of the budget deficit in 1986 and beyond. Actions to reduce the deficit are expected to amount to \$50 billion in fiscal year 1986--about \$5 billion more than assumed in the last Greenbook. Thus, the federal budget deficit, including off-budget outlays, is expected to be a bit above \$190 billion in fiscal year 1986, down from \$212 billion during fiscal year 1985. In part because of the move toward greater fiscal restraint, interest rates are expected to move down over the year. Growth of M1 is expected to be around the middle of the FOMC's tentative 4 to 7 percent target range. With interest rates and real activity somewhat lower, the projected path for the foreign exchange value of the dollar has been revised down very slightly, but the decline over the coming year is still assumed to be significantly slower than during the past three quarters.

The staff's outlook for real activity in 1986 is for a somewhat slower rise than in the last Greenbook, largely because of our revised fiscal assumptions. Real GNP is projected to rise 2.1 percent, which is about the same as the current estimate for 1985 as a whole. Federal spending is projected to decelerate sharply as budget cuts reduce purchases; reductions in transfers and grants also will spill over into spending in other sectors. Consumption, which has grown more rapidly than income this year, is expected to rise at a more moderate rate in 1986. Business fixed investment, on balance, is expected to grow slowly for the second year in a row, as some firming in demand for producers' durable equipment offsets a weakening in outlays for nonresidential construction. Offsetting

these factors is a marked improvement in net exports after mid-year; with U.S. goods becoming more price competitive, exports are projected to register their first sustained increase since 1979 while import growth is damped. Moreover, as mortgage rates move lower, a gradual improvement in housing starts should maintain moderate growth in spending for residential construction.

The slow rise in real GNP during 1986 is expected to leave a margin of slack in labor and product markets. Both the civilian unemployment rate and the industrial capacity utilization rate are projected to remain virtually flat over the year at levels that historically were associated with no emerging demand pressures on wages and prices. Rather, the slight acceleration in both wages and prices projected for next year reflects in large part the effects of the declining dollar. In addition, food prices are expected to pick up a bit from the relatively low rate of increase posted in 1985. Overall, the gross domestic business product fixed-weighted price index is projected to rise at a 3-3/4 percent annual rate in 1986, after an estimated increase of 3-1/2 percent during 1985.

Detailed data on these projections are shown on the tables that follow.

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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			
		10/30/85	12/11/85	10/30/85	12/11/85	10/30/85	12/11/85	10/30/85	12/11/85	10/30/85	12/11/85
Annual changes:											
1983	<1>	7.7	7.7	3.7	3.7	3.7	3.7	4.6	4.6	9.6	9.6
1984	<1>	10.8	10.8	6.8	6.8	4.0	4.0	4.3	4.3	7.5	7.5
1985		6.2	6.2	2.4	2.5	3.6	3.6	4.2	4.3	7.2	7.2
1986		6.0	5.9	2.4	2.4	3.5	3.6	3.9	3.9	7.2	7.2
Quarterly changes:											
1984	Q1 <1>	14.9	14.9	10.1	10.1	4.2	4.2	3.4	3.4	7.9	7.9
	Q2 <1>	10.7	10.7	7.1	7.1	4.1	4.1	5.4	5.4	7.5	7.5
	Q3 <1>	5.6	5.6	1.6	1.6	4.0	4.0	4.9	4.9	7.4	7.4
	Q4 <1>	7.1	7.1	4.3	4.3	3.5	3.5	3.9	3.9	7.2	7.2
1985	Q1 <1>	5.6	5.6	.3	.3	3.6	3.6	4.6	4.6	7.3	7.3
	Q2 <1>	4.5	4.5	1.9	1.9	3.7	3.7	3.8	3.8	7.3	7.3
	Q3 <1>	6.7	6.7	3.3	4.3	2.6	2.8	3.5	3.7	7.2	7.2
	Q4	6.0	6.3	2.6	2.6	3.3	3.4	3.5	3.8	7.1	7.1
1986	Q1	5.7	6.0	2.1	2.0	3.7	4.0	3.8	4.0	7.1	7.1
	Q2	6.0	5.2	2.2	1.8	3.7	3.6	4.2	4.1	7.2	7.2
	Q3	6.2	5.7	2.4	2.1	3.9	3.7	4.3	4.1	7.2	7.2
	Q4	6.9	6.8	2.8	2.6	4.0	3.7	4.5	4.1	7.2	7.3
Two-quarter changes: <2>											
1984	Q2 <1>	12.8	12.8	8.6	8.6	4.2	4.2	4.4	4.4	-1.0	-1.0
	Q4 <1>	6.4	6.4	2.9	2.9	3.8	3.8	4.4	4.4	-.3	-.3
1985	Q2 <1>	5.1	5.1	1.1	1.1	3.7	3.7	4.2	4.2	.1	.1
	Q4	6.3	6.5	2.9	3.4	2.9	3.1	3.5	3.7	-.2	-.2
1986	Q2	5.8	5.6	2.1	1.9	3.7	3.8	4.0	4.1	.1	.1
	Q4	6.5	6.2	2.6	2.3	4.0	3.7	4.4	4.1	.0	.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>	9.5	9.5	5.7	5.7	4.0	4.0	4.4	4.4	-1.3	-1.3
1985	Q4	5.7	5.8	2.0	2.2	3.3	3.4	3.9	4.0	-.1	-.1
1986	Q4	6.2	5.9	2.4	2.1	3.8	3.7	4.2	4.1	.1	.2

<1> Actual.

<2> Percent change from two quarters earlier.

<3> Percent change from four quarters earlier.

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

<1> Balance of payments data and details underlying these estimates are shown in the International Developments section of this part of the Greenbook.
 <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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PERCENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Annual rates compounded quarterly)

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

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

<2> Uses expenditures in 1972 as weights.

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

	1985				Projected 1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Gross National Product	3810.6	3853.1	3915.9	3976.3	4035.1	-4086.9	-4144.0
Gross domestic purchases	3885.2	3947.1	4019.9	4088.6	4140.7	4197.0	4254.5	4315.3
Final sales	3770.0	3835.2	3916.2	3953.6	4014.0	4062.8	4118.4	4183.7
Private	2978.1	3024.3	3066.7	3091.8	3148.6	3192.2	3239.2	3294.7
Domestic final purchases	3052.6	3118.3	3170.7	3204.0	3254.2	3302.3	3349.8	3397.8
Personal consumption expenditures	2446.5	2493.0	2539.0	2562.9	2605.6	2643.5	2679.8	2716.4
Goods	1212.1	1231.1	1253.6	1255.2	1274.1	1286.3	1297.7	1309.8
Services	1234.4	1261.9	1285.3	1307.7	1331.5	1357.2	1382.1	1406.6
Gross private domestic investment	646.8	643.2	631.5	663.8	669.8	682.9	695.5	709.8
Residential structures	155.2	158.0	163.2	168.2	171.2	177.2	183.7	189.7
Business fixed investment	450.9	467.3	468.6	472.9	477.5	481.7	486.2	491.6
Change in business inventories	40.7	17.9	-.3	22.7	21.1	24.0	25.5	28.5
Nonfarm	34.1	11.4	-.9	21.5	16.3	21.1	23.7	26.7
Net exports of goods and services <1>	-74.5	-94.0	-104.0	-112.3	-105.6	-110.1	-110.5	-103.1
Exports	360.7	347.7	346.8	353.5	361.6	368.9	377.5	391.2
Imports	435.2	441.6	450.8	465.8	467.2	479.0	488.0	494.2
Gov't. purchases of goods and services	791.9	810.9	849.5	861.9	865.4	870.6	879.2	889.0
Federal <2>	319.9	324.2	350.6	355.5	351.5	349.6	351.3	354.3
State and local	472.0	486.7	498.8	506.4	513.9	521.0	527.9	534.7
Gross national product in constant (1972) dollars	1663.5	1671.3	1688.9	1699.6	1708.0	1715.5	1724.3	1735.3
Personal income	3143.8	3174.7	3197.4	3260.3	3315.3	3363.7	3412.3	3466.4
Wage and salary disbursements	1882.7	1910.6	1933.6	1968.2	1998.8	2028.5	2057.3	2087.8
Disposable personal income	2654.8	2726.5	2710.7	2762.9	2819.8	2856.8	2894.5	2937.1
Saving rate (percent)	4.5	5.1	2.7	3.6	4.0	3.8	3.7	3.8
Corporate profits with I.V.A. and C.C. Adj.	292.3	298.5	321.4	313.1	302.6	296.3	295.4	296.9
Corporate profits before tax	222.3	221.0	232.8	224.5	215.2	210.7	208.8	209.3
Federal government surplus or deficit (-) (N.I.A. basis)	-165.1	-214.1	-201.0	-201.1	-195.5	-182.4	-174.4	-163.0
High employment surplus or deficit (-) <3>	-129.4	-178.3	-169.2	-168.6	-160.7	-144.5	-134.1	-120.9
State and local government surplus or deficit(-) (N.I.A. basis)	53.7	50.3	49.6	48.3	48.1	47.5	48.4	49.8
Excluding social insurance funds	8.3	4.2	3.0	1.5	.8	-.6	-.5	.1
Civilian labor force (millions)	115.2	115.2	115.5	116.1	116.7	117.1	117.6	118.1
Unemployment rate (percent)	7.3	7.3	7.2	7.1	7.1	7.2	7.2	7.3
Nonfarm payroll employment	96.6	97.3	98.0	98.7	99.1	99.5	99.9	100.3
Manufacturing	19.6	19.4	19.3	19.4	19.4	19.4	19.4	19.5
Industrial production (1977=100)	123.8	124.2	124.7	125.2	125.8	126.4	127.2	128.1
Capacity utilization: all manufacturing (percent)	80.5	80.3	80.3	80.1	80.0	79.9	79.8	79.9
Materials (percent)	81.5	80.4	79.5	78.9	78.8	78.7	78.7	78.7
Housing starts, private (million units, A.R.)	1.80	1.77	1.66	1.75	1.75	1.80	1.85	1.85
New auto sales (millions, A.R.)	10.87	10.92	12.31	10.00	10.70	10.70	10.70	10.70
Domestic models	8.46	8.27	9.40	6.80	7.70	7.70	7.60	7.60
Foreign models	2.42	2.65	2.90	3.20	3.00	3.00	3.10	3.10

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

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

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

	1985				Projected 1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Constant (1972) Dollars							
Gross national product	.3	1.9	4.3	2.6	2.0	1.8	2.1	2.6
Gross domestic purchases	3.9	3.2	5.3	2.7	1.8	1.7	1.7	1.7
Final sales	-3.3	4.6	5.7	.3	1.9	1.5	2.2	2.6
Private	-4.4	4.8	2.8	.1	3.1	2.3	2.6	3.0
Domestic final purchases	4.1	6.4	4.1	.3	2.8	2.3	2.0	1.8
Personal consumption expenditures	5.2	4.8	5.4	-.7	3.0	2.0	1.6	1.5
Goods	5.4	5.4	8.0	-3.7	3.5	1.5	1.1	1.0
Services	5.0	4.2	2.4	2.9	2.5	2.7	2.3	2.0
Gross private domestic investment	3.1	-3.5	-8.3	18.1	2.5	4.5	3.0	3.2
Residential structures	5.3	6.4	11.5	10.9	4.7	11.4	12.0	10.0
Business fixed investment	-1.6	14.5	-3.7	2.3	1.3	.8	1.1	1.4
Gov't. purchases of goods and services	.3	3.7	19.0	1.4	-2.9	-1.8	.5	1.0
Federal	.7	-.4	40.9	.5	-9.0	-6.3	-.8	.3
National defense	-.2	7.2	25.8	.4	1.2	-3.2	-2.0	.8
State and local	.0	6.7	5.1	2.1	1.9	1.7	1.5	1.5
Disposable personal income	-1.6	8.2	-4.3	3.2	4.6	1.5	1.4	1.9
Current Dollars								
Gross national product	5.6	4.5	6.7	6.3	6.0	5.2	5.7	6.8
Gross domestic purchases	7.6	6.5	7.6	7.0	5.2	5.5	5.6	5.8
Final sales	5.2	7.1	8.7	3.9	6.2	5.0	5.6	6.5
Personal consumption expenditures	8.6	7.8	7.6	3.8	6.8	5.9	5.6	5.6
Goods	6.6	6.4	7.5	.5	6.2	3.9	3.6	3.8
Services	10.6	9.2	7.6	7.2	7.5	7.9	7.5	7.3
Gross private domestic investment	5.8	-2.2	-7.1	22.1	3.6	8.1	7.6	8.5
Residential structures	4.6	7.4	13.7	12.8	7.3	14.8	15.5	13.7
Business fixed investment	3.0	15.3	1.2	3.7	3.9	3.6	3.9	4.5
Gov't. purchases of goods and services	5.9	10.0	20.4	6.0	1.6	2.5	4.0	4.5
Federal	5.4	5.6	36.7	5.7	-4.4	-2.1	2.0	3.5
National defense	4.0	12.8	25.2	7.1	5.5	.6	1.7	3.4
State and local	6.3	13.0	10.4	6.2	6.0	5.7	5.4	5.3
Disposable personal income	1.6	11.2	-2.3	7.9	8.5	5.3	5.4	6.0
Personal income	6.3	4.0	2.9	8.1	6.9	6.0	5.9	6.5
Wage and salary disbursements	7.8	6.1	4.9	7.4	6.4	6.1	5.8	6.1
Corporate profits with I.V.A. and C.C.Adj.	1.0	8.8	34.4	-9.9	-12.8	-8.1	-1.2	2.0
Corporate profits before tax	-10.7	-2.3	23.1	-13.5	-15.6	-8.1	-3.6	1.0
Nonfarm payroll employment	3.3	2.9	2.6	3.0	1.8	1.6	1.5	1.6
Manufacturing	.0	-2.7	-2.0	.8	.6	.2	.6	1.0
Nonfarm business sector								
Output per hour	-3.1	1.2	2.1	.2	.3	.6	1.2	1.4
Compensation per hour	5.0	3.4	3.7	4.0	4.6	4.2	4.4	4.6
Unit labor costs	8.4	2.1	1.6	3.8	4.3	3.6	3.2	3.2
GNP implicit deflator <1>	5.4	2.6	2.3	3.7	4.0	3.4	3.5	4.1
Gross domestic business product								
fixed-weighted price index <2>	3.6	3.7	2.8	3.4	4.0	3.6	3.7	3.7
Excluding food and energy	4.6	3.8	3.7	3.8	4.0	4.1	4.1	4.1
Consumer price index (all urban)	3.2	4.2	2.4	3.7	4.3	3.7	3.9	4.0
Industrial production	2.1	1.3	1.6	1.7	1.9	1.9	2.4	2.9

<1> Excluding Federal pay increase, the rate of change in 1985-Q1 is 5.0 percent and in 1986-Q1 is 3.8 percent.
<2> Uses expenditures in 1972 as weights.

	1979	1980	1981	1982	1983	1984	---Projected---	
							1985	1986
Gross national product	2417.8	2631.7	2957.7	3069.2	3304.8	3662.8	3889.0	4119.5
Gross domestic purchases	2404.5	2607.7	2929.8	3050.2	3313.1	3727.0	3985.2	4226.8
Final sales	2403.5	2641.4	2931.7	3095.4	3318.3	3604.6	3868.8	4094.7
Private	1929.2	2103.7	2335.2	2444.9	2632.7	2857.2	3040.2	3218.7
Domestic final purchases	1915.9	2079.7	2307.2	2425.9	2641.0	2921.4	3136.4	3326.0
Personal consumption expenditures	1507.1	1668.0	1849.1	1984.9	2155.9	2341.8	2510.3	2661.3
Goods	813.4	883.5	966.1	1002.6	1081.5	1175.7	1238.0	1292.0
Services	693.7	784.5	883.0	982.2	1074.4	1166.1	1272.3	1369.3
Gross private domestic investment	423.0	401.9	484.2	414.9	471.6	637.8	646.3	689.5
Residential construction	118.5	102.9	104.3	91.3	132.2	153.9	161.1	180.4
Business fixed investment	290.2	308.8	353.9	349.6	352.9	425.7	464.9	484.2
Change in business inventories	14.3	-9.8	26.0	-26.1	-13.5	58.2	20.3	24.8
Nonfarm	8.6	-4.5	18.2	-23.9	-3.1	49.6	16.5	22.0
Net exports of goods and services <1>	13.2	23.9	28.0	19.0	-8.3	-64.2	-96.2	-107.3
Exports	281.3	338.8	369.9	348.4	336.2	364.3	352.2	374.8
Imports	268.1	314.8	341.9	329.4	344.4	428.5	448.3	482.1
Gov't. purchases of goods and services	474.4	537.8	596.5	650.5	685.5	747.4	828.5	876.0
Federal <2>	168.3	197.0	228.9	258.9	269.7	295.4	337.5	351.7
State and local	306.0	340.8	367.6	391.5	415.8	452.0	491.0	524.4
Gross national product in constant (1972) dollars	1479.4	1475.0	1512.1	1480.0	1534.7	1639.3	1680.8	1720.8
Personal income	1951.1	2165.3	2429.4	2584.6	2744.2	3012.1	3194.0	3389.4
Wage and salary disbursements	1237.6	1356.7	1493.1	1568.7	1659.2	1804.0	1923.8	2043.1
Disposable personal income	1650.2	1828.9	2041.7	2180.5	2340.1	2576.8	2713.7	2877.1
Saving rate (percent)	5.9	6.0	6.7	6.2	5.0	6.1	4.0	3.8
Corporate profits with I.V.A. and C.C. Adj.	194.8	175.4	189.9	159.1	225.2	285.7	306.3	297.8
Corporate profits before tax	252.7	234.6	221.2	165.6	203.2	235.7	225.1	211.0
Federal government surplus or deficit (-) (N.I.A. basis)	-16.1	-61.2	-64.3	-148.2	-178.6	-175.8	-195.4	-178.8
High employment surplus or deficit (-)	-20.8	-36.4	-31.3	-61.6	-92.7	-139.6	-161.4	-140.1
State and local government surplus or deficit (-) (N.I.A. basis)	30.4	30.6	37.6	32.9	44.1	52.9	50.5	48.5
Excluding social insurance funds	6.6	3.5	7.8	-8	6.6	10.4	4.2	.0
Civilian labor force (millions)	105.0	106.9	108.7	110.2	111.6	113.5	115.5	117.4
Unemployment rate (percent)	5.8	7.1	7.6	9.7	9.6	7.5	7.2	7.2
Nonfarm payroll employment (millions)	89.8	90.4	91.2	89.6	90.2	94.5	97.7	99.7
Manufacturing	21.0	20.3	20.2	18.8	18.4	19.4	19.4	19.4
Industrial production (1967=100)	110.7	108.6	111.0	103.1	109.2	121.8	124.5	126.9
Capacity utilization: all manufacturing (percent)	84.6	79.3	78.3	70.3	74.0	80.8	80.3	79.9
Materials (percent)	87.1	81.1	81.1	71.7	75.3	82.3	80.1	78.8
Housing starts, private (million units, A.R.)	1.72	1.30	1.10	1.06	1.70	1.77	1.75	1.81
New auto sales (millions, A.R.)	10.68	9.04	8.56	8.00	9.18	10.43	11.04	10.70
Domestic models	8.36	6.62	6.24	5.77	6.77	7.97	8.23	7.65
Foreign models	2.32	2.42	2.32	2.23	2.41	2.46	2.81	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.

December 11, 1985

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

	1979	1980	1981	1982	1983	1984	---Projected---	
							1985	1986
<u>Constant (1972) Dollars</u>								
Gross national product	2.8	-.3	2.5	-2.1	3.7	6.8	2.5	2.4
Gross domestic purchases	2.0	-1.2	3.1	-1.2	5.0	8.7	3.7	2.4
Final sales	3.5	.5	1.5	-.7	3.2	5.0	3.5	2.2
Private	4.0	.1	1.6	-1.3	4.1	5.3	2.9	2.4
Domestic final purchases	2.9	-1.0	2.2	-.2	5.6	7.6	4.4	2.4
Personal consumption expenditures	2.7	.5	2.0	1.4	4.8	5.3	4.1	2.2
Goods	1.9	-1.4	1.7	.4	6.0	7.1	4.2	1.9
Services	3.7	2.7	2.3	2.5	3.4	3.2	3.9	2.7
Gross private domestic investment	-.2	-11.8	10.7	-15.8	13.7	31.2	.1	3.9
Residential structures	-5.3	-20.3	-5.5	-14.8	41.7	12.2	2.9	9.3
Business fixed investment	7.3	-2.4	5.6	-4.7	2.5	19.8	6.3	1.5
Gov't. purchases of goods and services	1.3	2.2	1.0	2.0	-.3	3.5	6.0	1.7
Federal	1.8	4.2	3.6	6.1	-.6	5.4	10.7	.6
National defense	2.6	3.9	5.1	7.6	7.1	5.8	7.9	2.9
State and local	1.1	1.0	-.6	-.6	.0	2.2	2.8	2.5
Disposable personal income	2.7	.6	2.7	.9	3.5	6.7	2.2	2.2
<u>Current Dollars</u>								
Gross national product	11.7	8.8	12.4	3.8	7.7	10.8	6.2	5.9
Gross domestic purchases	11.1	8.4	12.3	4.1	8.6	12.5	6.9	6.1
Final sales	12.4	9.9	11.0	5.6	7.2	8.6	7.3	5.8
Personal consumption expenditures	11.9	10.7	10.9	7.3	8.6	8.6	7.2	6.0
Goods	11.7	8.6	9.3	3.8	7.9	8.7	5.3	4.4
Services	12.2	13.1	12.6	11.2	9.4	8.5	9.1	7.6
Gross private domestic investment	9.4	-5.0	20.5	-14.3	13.7	35.2	1.3	6.7
Residential structures	6.6	-13.2	1.4	-12.4	44.7	16.4	4.7	12.0
Business fixed investment	16.6	6.4	14.6	-1.2	.9	20.6	9.2	4.2
Gov't. purchases of goods and services	9.8	13.4	10.9	9.0	5.4	9.0	10.9	5.7
Federal	9.6	17.1	16.2	13.1	4.2	9.5	14.3	4.2
National defense	11.5	17.3	17.2	16.8	11.7	10.5	11.7	6.9
State and local	9.9	11.4	7.9	6.5	6.2	8.7	8.6	6.8
Disposable personal income	12.0	10.8	11.6	6.8	7.3	10.1	5.3	6.0
Personal income	12.6	11.0	12.2	6.4	6.2	9.8	6.0	6.1
Wage and salary disbursements	11.9	9.6	10.1	5.1	5.8	8.7	6.6	6.2
Corporate profits with I.V.A. and C.C.Adj.	1.2	-9.9	8.3	-16.2	41.5	26.9	7.2	-2.8
Corporate profits before tax	10.3	-7.1	-5.7	-25.2	22.8	16.0	-4.5	-6.3
Nonfarm payroll employment	3.6	.6	.8	-1.7	.7	4.7	3.4	2.1
Manufacturing	2.6	-3.6	-.6	-6.9	-1.8	5.3	.1	.1
Nonfarm business sector								
Output per hour	-1.5	-.7	1.5	.2	3.5	2.7	.3	.8
Compensation per hour	9.0	10.3	9.6	8.0	4.9	4.1	4.0	4.2
Unit labor costs	10.7	11.1	8.0	7.7	1.4	1.4	3.7	3.4
GNP implicit deflator	8.6	9.2	9.6	6.0	3.8	3.8	3.6	3.5
Gross domestic business product								
fixed-weighted price index <1>	9.9	9.9	9.7	5.9	3.7	4.0	3.6	3.6
Excluding food and energy	8.6	8.5	9.4	7.0	4.6	4.3	4.3	3.9
Consumer price index (all urban)	11.3	13.5	10.3	6.1	3.2	4.3	3.5	3.8
Industrial production	3.9	-1.9	2.2	-7.1	5.9	11.6	2.2	1.9

<1> Uses expenditures in 1972 as weights.

December 11, 1985

FEDERAL SECTOR ACCOUNTS
(Billions of dollars)

	Fiscal Year 1984*	Fiscal Year 1985*	FY1986 ^e 2/3/		CY 1984*	CY1985 ^e FRB Staff	FRB staff estimates							
			Admin. 1/	FRB Staff			Calendar quarters; not seasonally adjusted							
							1984 IV*	1985 I*	1985 II*	1985 III*	1985 IV	1986 I	1986 II	1986 III
Unified budget receipts	666	734	780	774	683	741	166	174	206	188	173	179	227	195
Unified budget outlays	842	937	955	961	868	948	239	230	234	234	250	242	236	233
Surplus/deficit(-), unified budget	-175	-203	-175	-187	-184	-207	-72	-56	-28	-47	-77	-63	-9	-38
Surplus/deficit(-), off-budget agencies ⁴	-10	-9	-2	-5	-10	-11	1	-3	-5	-3	-1	-1	-2	-1
Combined deficit to be financed	-185	-212	-178	-192	-195	-218	-71	-59	-32	-50	-77	-64	-11	-40
Means of financing combined deficit:														
Net borrowing from public	171	197	180	193	199	213	64	42	45	46	80	56	25	32
Decrease in cash operating balance	7	13	0	-8	-6	3	13	4	-10	7	2	1	-11	0
Other ⁵	8	1	-2	7	2	3	-6	13	-3	-3	-5	7	-3	7
Cash operating balance, end of period	30	17	20	25	18	15	18	14	24	17	15	14	25	25
Memo: Sponsored agency borrowing ⁶	30	20	n.a.	21	30	22	4	4	8	4	6	5	5	5
<u>NIA Budget</u>							Seasonally adjusted annual rates							
Receipts	688	750	809	800	705	766	722	771	734	772	785	792	804	817
Expenditures	860	944	978	988	881	961	920	937	948	973	987	987	986	992
Purchases	283	328	343	352	295	338	316	320	324	351	356	352	350	351
Defense	215	240	255	263	222	247	232	234	241	255	259	263	263	264
Nondefense	68	87	88	90	74	90	84	86	83	96	96	89	86	87
All other expenditures	577	617	635	636	586	624	604	617	624	622	631	636	637	640
Surplus/deficit(-)	-172	-195	-169	-188	-176	-195	-198	-165	-214	-201	-201	-196	-182	-174
High employment surplus/deficit(-) evaluated at 6 percent unemployment	-126	-162	n.a.	-152	-140	-161	-169	-129	-178	-169	-169	-161	-145	-134
	*--actual		e--estimated				n.a.--not available							

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1. Mid-session Review, August 30, 1985.
2. The Congressional Budget Resolution, passed August 1, 1985, shows revenues of \$796 billion, combined unified and off-budget outlays of \$968 billion, and a total deficit of \$172 billion in fiscal year 1986.
3. The latest CBO budget estimates that incorporate the Budget Resolution policy assumptions and the August 1985 CBO economic forecast show revenues of \$790 billion, combined unified and off-budget outlays of \$965 billion, and a total deficit of \$175 billion in fiscal year 1986.

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

4. Includes Federal Financing Bank, Postal Service Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank, and Strategic Petroleum Reserve.
5. Checks issued less checks paid, accrued items and other transactions.
6. 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. Short-term interest rates are little changed on balance since the November FOMC meeting, while long-term rates have fallen 25 to 50 basis points. The rally in long-term markets apparently was fueled by heightened market sentiment that monetary policy would remain accommodative in the absence of signs of strongly accelerating activity or increased inflation pressures. Most recently, progress by the Congress towards a compromise position on the Gramm-Rudman deficit reduction amendment to the debt ceiling bill and OPEC oil price developments led to further declines in bond rates.

M1 resumed rapid expansion in November, moving this aggregate further above its second-half target range. The pickup in M1 bolstered M2 and M3 growth in November. The nontransactions component of M2, however, remained sluggish, with much of the weakness concentrated in money funds and small time deposits. The low opportunity cost of holding more liquid, insured deposits, coupled with increased household interest in higher yielding bond funds and unit trusts may have restrained growth of money funds and small time deposits in recent months. Growth in M3 in November, at a 5 percent annual rate, was entirely due to its M2 component, as continuing strength in large time deposit issuance was more than offset by weakness in other components of M3. M3 remains near the midpoint of its 1985 target range, while M2 is in the upper portion of its range.

Debt of domestic nonfinancial sectors appears to have expanded more rapidly in November and early December. Tax-exempt bond offerings surged to record levels, and the Treasury marketed an enormous volume of offerings

after the temporary raising of the debt ceiling on November 14. The combined deficit in the fourth quarter is expected to total about \$78 billion and will be financed largely by borrowing from the public. The temporary extension of the debt ceiling expired on December 6, resulting in a postponement of the December 9 bill auction. If the Gramm-Rudman amendment is not passed and signed on December 11, Congress is expected to enact a further temporary extension of the debt ceiling to permit financing on December 12, when the Treasury would otherwise exhaust its cash balance.

A sizable portion of Treasury borrowing in the fourth quarter has been in the form of nonmarketable special Treasury issues purchased by state and local governments with the proceeds from tax-exempt advance refunding bonds. Refunding issues have surged of late, attracted by the lowest rates on tax-exempt debt in five years and by concerns that congressional legislation currently under consideration may prohibit such issues after year-end. The volume of other tax-exempt debt threatened with restrictions, including hospital and multi-family housing bonds, also has been heavy. Indeed, gross offerings of tax-exempt bonds totaled a record \$22 billion in November, exceeding the previous monthly high by \$3 billion. Municipal market activity is expected to continue at a hectic pace until late this month. Despite the huge slate of new offerings, tax-exempt yields have fallen only slightly less than taxable rates since the last FOMC meeting; demands by commercial banks, mutual bond funds, and insurance companies have been quite strong.

Borrowing by nonfinancial businesses also has picked up in the fourth quarter, spurred by low bond rates and increased merger activity. Several large mergers were completed in November, the bulk of which were

financed primarily with short-term credit, bank loans and commercial paper. But bond volume also was strong; about a third of new offerings were to refinance previous mergers. The recent rally in stock prices began to stimulate a greater volume of new equity issues in early December; nonetheless, equity retirements in the fourth quarter again will exceed new issues by a wide margin.

Home mortgage debt accelerated in the third quarter as interest rates eased, and signs indicate that activity is continuing at a robust pace in the current quarter. In October, loan originations by FSLIC-insured institutions rose to a new high, and a record level of new mortgage commitments suggests that these institutions will remain active in mortgage lending for awhile. Real estate lending at commercial banks also strengthened in October and remained fairly strong in November. During the intermeeting period, mortgage rates generally moved down about 1/2 percentage point in both primary and secondary markets; the yield on fixed-rate, conventional loans stood at 11-1/2 percent in early December, about 3 percentage points below its 1984 high.

With the end of special auto financing incentives, consumer installment credit growth in October slowed from the rapid September pace to near the somewhat more moderate growth of the June through August period. Although rising delinquency rates and higher personal bankruptcies have been accompanied by some tightening of mortgage and other lending standards, recent bank surveys indicate continued willingness by these institutions to make consumer loans.

Outlook. The staff expects that a rather sluggish pace of economic activity in the first half of 1986 will be accompanied by some slowing in credit growth from the hectic fourth-quarter rate, with interest rates easing down further from current levels. The projection assumes that legislative developments on the fiscal front will continue to exert a constructive influence on the fixed-income markets.

In the household sector, consumer credit growth may pick up for a time if auto manufacturers employ broad concession programs to clear out inventories; however, the underlying trend in installment debt growth is expected to slow. Although rates on consumer loans have come down and credit appears to be readily available, the growing burden of household debt and associated financial stresses could lead to further tightening of standards by lenders and more cautious use of credit by consumers next year. In mortgage markets, a firming of nonrate terms has been underway for some time; even so, home mortgage borrowing is expected to remain strong in association with the expected further decline in costs of mortgage credit.

Tax-exempt debt issuance should drop sharply after the current year-end rush, allowing municipal rates to move down relative to taxable yields. However, to the extent that much of the recent activity in this market has been borrowing in advance of spending needs or for refunding purposes, proceeds from new offerings likely have been invested in financial assets, and the fall-off may have a limited net impact on credit market pressures. Treasury debt also should decelerate markedly from the fourth quarter, as the Treasury returns to normal funding schedules and typical seasonal factors lower the deficit to about \$64 billion in the first quarter.

Nonetheless, federal borrowing will continue to be sizable next year even if deficit-reduction legislation is passed.

Corporate borrowing in taxable markets likely will continue near its recent pace in the early months of next year. Announcements of possible large merger transactions imply further sizable equity retirements that would bolster credit use. The financing gap is not expected to widen appreciably, however, as corporations pursue cautious fixed investment and inventory strategies in the current economic environment. Meanwhile, corporate borrowing in tax-exempt markets likely will be markedly curtailed until the tax-exempt status of private-purpose issues is clarified by Congress.

INTERNATIONAL DEVELOPMENTS

Recent developments. The weighted average foreign exchange value of the dollar has declined about 1 per cent further since the last FOMC meeting, bringing its total depreciation to 9 percent since the G-5 announcement on September 22, and to nearly 23 percent from its peak in February. Early in the intermeeting period the dollar continued its sharp decline against the yen, spurred by a further increase in Japanese interest rates. The rise in Japanese rates has since been partly reversed, and the dollar has firmed somewhat against the yen in recent weeks. Since mid-November the decline in the dollar has been more pronounced against the mark as U.S. long-term interest rates have declined while German rates have remained about unchanged.

. The Canadian dollar has been under considerable downward pressure, as market attention has continued to focus on the difficulties of several Canadian banks.

Foreign net purchases of U.S. Treasury securities were reduced somewhat in October from a very high third-quarter rate. Private Japanese purchases continued to account for most of the total. Foreign net purchases of U.S. corporate bonds totalled more than \$4 billion in October, exceeding the high average monthly rate recorded in the third quarter. U.S. banks reported a large net inflow of funds from abroad in

October, more than reversing an outflow in September. The October inflow included a sizable reduction in the net claims of domestic offices on their foreign affiliates.

Revised U.S. merchandise trade data now available for the third quarter show a further widening of the deficit to \$133 billion (s.a.a.r.). Exports declined further reflecting a drop-off in both agricultural and nonagricultural shipments. Imports recorded an increase in the third quarter, with a rise in the volume of nonoil imports more than offsetting a fall in oil imports. The average unit value of nonoil imports rose slightly in the third quarter following three quarters of declines, as sizable increases in the prices of some imported manufactured goods more than offset continued declines in the prices of basic commodities and materials.

Trade data for the month of October are available on an unrevised basis, but uncertainty about the size of the carry-over of late documents makes it impossible to assess October imports at this time. Exports appear to have declined somewhat further in October.

Real GNP in major foreign industrial countries, on average, has continued to grow at a moderate pace. Some slowing in Japanese growth has been offset by a strengthening in Germany and Canada. Inflation abroad remains low, with some countries showing further declines in recent months. The external positions of the major foreign industrial countries have continued to strengthen, with all showing trade surpluses in the latest month for which data are available.

Among developing countries, Argentina has achieved a sharp reduction in its inflation to an average annual rate of 32 per cent over the past four months. In late November that country became fully

current in its interest payments to foreign banks for the first time in three years. However, Argentina has had some difficulty in meeting the latest IMF performance criteria for its fiscal deficit. Mexico released plans last month to reduce substantially its public sector deficit. Efforts by the government to reduce its domestic debt service expenditures by holding down interest rates were among several factors contributing to increasing capital flight in recent months. Early in November the Bank of Mexico imposed new restrictions on the peso accounts of foreign banks. This action was intended in part to stem the flight of capital, and has effectively ended trading in pesos in the United States. Recent developments in Brazil could pose further difficulties for that country's rescheduling negotiations. In mid-November the Brazilian government announced the liquidation of three private banks without guaranteeing full compensation for the banks' creditors.

Outlook. The staff continues to project that the dollar will decline gradually during 1986 from its current level, at a significantly slower rate than has been recorded over the past three quarters. The dollar's projected path has been revised downward slightly in light of the outlook for greater fiscal restraint and its implications for somewhat lower U.S. growth and interest rates. Real growth in foreign industrial countries next year, on average, is expected to continue at about the moderate rate recorded over the past year. Growth in developing countries is expected to increase only slightly. With U.S. growth now expected to be lower in 1986, the outlook for the current account deficit in 1986 has been revised down slightly, to a level about unchanged from an estimated \$126 billion for 1985. This outlook

incorporates the assumption of a further erosion of oil prices during 1986, by about \$2 per barrel, although there is some possibility of an even greater decline in prices.

DECEMBER 11, 1985

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

	1984-	ANNUAL		1984		1985		1986					
		1984-	1985-P	1986-P	Q3-	Q4-	Q1-	Q2-	Q3-	Q4-P	Q1-P	Q2-P	Q3-P
1. GNP EXPORTS AND IMPORTS 1/													
CURRENT \$, NET	-64.2	-96.2	-107.2	-90.6	-56.0	-74.5	-94.0	-104.0	-112.3	-105.6	-110.1	-110.4	-102.9
EXPORTS OF G+S	364.3	352.2	374.9	368.6	367.2	360.7	347.7	346.8	353.5	361.6	368.9	377.6	391.3
IMPORTS OF G+S	428.5	448.3	482.1	459.3	423.2	435.2	441.6	450.8	465.8	467.2	479.0	488.1	494.3
CONSTANT 72 \$, NET	-15.0	-34.9	-36.6	-27.0	-13.4	-28.4	-33.8	-38.4	-39.0	-38.3	-38.4	-36.7	-33.0
EXPORTS OF G+S	146.0	140.0	144.1	147.4	147.1	143.7	137.9	138.0	140.6	142.0	142.7	144.2	147.5
IMPORTS OF G+S	161.1	175.0	180.7	174.4	160.5	172.1	171.8	176.4	179.6	180.3	181.0	180.9	180.5
2. U.S. MERCHANDISE TRADE BALANCE 2/													
EXPORTS	220.3	215.4	231.4	222.1	225.4	222.8	213.0	210.8 ^P	215.1	218.9	226.2	234.9	245.7
AGRICULTURAL	38.4	28.9	27.3	36.9	38.3	33.5	28.4	25.8 ^P	28.1	27.5	27.4	27.2	27.2
NONAGRICULTURAL	181.9	186.5	204.1	185.3	187.2	189.4	184.5	185.0 ^P	187.0	191.3	198.8	207.8	218.4
IMPORTS	328.6	345.1	365.4	352.1	323.6	341.0	345.0	341.6 ^P	353.0	352.5	363.3	370.8	375.0
PETROLEUM AND PRODUCTS	57.5	49.5	44.7	57.8	56.8	45.2	52.8	48.6 ^P	51.3	42.9	46.0	46.3	43.8
NONPETROLEUM	271.1	295.7	320.7	294.4	266.9	295.7	292.2	293.0 ^P	301.7	309.6	317.3	324.5	331.2
3. U.S. CURRENT ACCOUNT BALANCE													
OF WHICH: NET INVESTMENT INCOME	-101.5	-126.3	-128.1	-130.0	-101.9	-121.3	-127.2	-123.4 ^P	-133.4	-125.8	-130.2	-130.5	-125.9
	19.1	19.3	17.9	13.0	16.0	10.1	22.3	23.0 ^P	21.8	20.8	18.8	16.5	15.6
4. FOREIGN OUTLOOK 3/													
REAL GNP--TEN INDUSTRIAL 4/	3.1	2.7	2.8	4.8	3.4	0.4	4.4	3.3	2.8	2.6	2.6	2.5	2.7
REAL GNP--NONOPEC LDC 5/	4.1	3.5	3.7	4.2	3.5	3.0	3.1	3.4	3.6	3.8	3.8	3.8	3.9
CONSUMER PRICES--TEN IND. 4/	4.9	4.3	3.6	2.6	4.8	5.4	5.7	1.4	3.6	4.1	4.0	3.4	3.1

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1/ ECONOMIC ACTIVITY AND PRODUCT ACCOUNT DATA.

2/ INTERNATIONAL ACCOUNTS BASIS.

3/ PERCENT CHANGE, ANNUAL RATES.

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

5/ WEIGHTED BY SHARE IN NONOPEC LDC GNP.

P/ PROJECTED