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August 12, 1981

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

Summary. Although the housing and auto markets remain extremely weak, there have been no signs of a cumulative contraction in overall activity following the second quarter decline. During July, the labor market showed surprising strength, and industrial production edged up. All of the broad measures of inflation have slowed recently, reflecting in large part stability in food and energy prices; increases in wage rates also have decelerated from the pace observed in 1980.

Early indications suggest that the index of industrial production rose about 1/4 percent or somewhat more in July. Production of business equipment appears to have shown a substantial gain, although truck and auto assemblies were reduced last month. The index has shown relatively little movement since January, and in July was only 1 percent above the level at the beginning of the year.

Employment at nonfarm establishments rose 385,000 in July--the largest one-month gain during the past year. Increases were reported in most major industries except construction. Manufacturing employment rose considerably, following a small drop in June, with more than one-third of the increase in the capital goods industries; by contrast, demand in transportation equipment remained weak. The strength of labor demand also was evident in the household survey and the unemployment rate fell to 7 percent from the 7.3 percent rate that had prevailed during most of 1981.

The weakness in auto demand, which characterized the second quarter, persisted through July. Sales of domestic models rose in July, but only to a 5.9 million unit pace. Although somewhat improved from the 5.6'

million unit rate of the preceding three months, the July figure was well below earlier industry expectations and lagged behind production by about one and a quarter million units (annual rate). Responses to the University of Michigan's Consumer survey suggest that the sluggishness of auto demand is largely a result of the high prices of cars and credit market conditions. Retail sales excluding autos and other nonconsumption items increased in June, but that followed a sizable drop in May.

Activity in housing markets weakened further in the early summer months as financial conditions continued to tighten. Total private housing starts declined in June, following a sizable drop in May. At a one million unit rate, housing starts were at their lowest level since early 1975 except for one month in the spring of 1980. Sales of new houses fell sharply further, by 17 percent, in June. The recent level of sales was below the pace at the trough of the 1973-75 downturn, and just barely higher than the troughs in 1966 and 1970.

Real business fixed investment has been on a downtrend recently, following a surge in outlays early in the year. The weakness has occurred in capital goods shipments, business purchases of motor vehicles, and construction spending. The only major category posting increases has been the volatile petroleum drilling component. Indicators of future investment outlays suggest further sluggishness over the near term. New orders for nondefense capital goods fell 2.9 percent in real terms in June--the third consecutive monthly decline. Permits for new commercial and industrial buildings, which tend to lead actual construction spending by about 3 to 4 quarters, fell sharply at the end of 1979 and have been at a distinctly lower level since then.

Inventories have continued to accumulate at automobile dealers, but aside from this sector, data through June suggest that businesses generally have held stocks about in line with sales. Inventories of domestic autos rose another 170,000 units in July; since the end of the rebate programs in early April, stocks have increased by more than one-half million units, and the days' supply (at current sales rates) has nearly doubled. The book value of manufacturers' inventories was about unchanged in June, following a substantial buildup in May. At the wholesale level, inventories climbed rapidly in June, with most of the rise at automotive distributors (primarily imported autos and recreational vehicles) and at wholesalers of petroleum products.

Aggregate measures of inflation have slowed significantly this year. Excluding food, energy, and homeownership, the CPI increased at an 8.4 percent rate in the first half of 1981, compared with a 9.9 percent rise during 1980. However, homeownership costs, which had slowed during the first part of the year, surged in May and June, reflecting rising mortgage rates and home purchase prices. The easing of underlying inflation has been accompanied by a slowing of wage pressures. The deceleration of wage rates has been most pronounced in the heavily unionized manufacturing sector, but some slowing also is evident in the trade and service sectors.

Outlook. Real GNP is expected to show little change in the third quarter, following a reported 2 percent decline in the second quarter. The sluggishness in activity is likely to be most evident in credit-sensitive sectors. Housing starts are expected to remain extremely low for the next several months and outlays for residential construction are

likely to drop substantially, reflecting earlier declines in housing starts. Real business fixed investment also is projected to decline further, particularly in the construction area. In contrast, personal consumption expenditures are projected to show a small gain, led by a modest rebound in auto sales from their recent slump. The projection of inflation in the current quarter has been lowered 1/4 percentage point from the rate shown in the July Greenbook, mainly because of lower expected food prices; the GDBP fixed-weighted price index is expected to rise at an 8 percent annual rate, about the same as in the second quarter.

The financial assumptions underlying the staff's economic projections have been revised to reflect the recent decisions of the FOMC. Shift-adjusted M1-B is now assumed to grow 3-1/2 percent in 1981 (rather than the 4-3/4 percent, as indicated last month) and 4 percent during 1982 (down 1/4 percentage point). M2 is expected to increase at a pace around the upper end of the Committee's targeted ranges for 1981 and 1982. Short-term interest rates are projected to fluctuate near recent high levels over the projection period, although an improvement in inflation expectations may provide the foundation for some easing in long-term rates.

In regard to fiscal policy, the staff has adjusted its assumptions to take account of Administration budget re-estimates, recent Congressional actions and incoming budget data. The provisions of the recent tax reduction legislation had been largely anticipated in the July Greenbook. Tax receipts for FY1982 have been reduced, however, by around \$4 billion, mainly because of reduced estimates of collections of windfall profits

taxes. In addition, outlays were raised by a similar amount reflecting recalculations of programs costs. As a result, the unified budget deficit is projected to reach \$88 billion in FY1982, compared with \$79 billion in the July Greenbook. The deficit for FY1981 currently is estimated to be almost \$60 billion.

Pressures in financial markets are expected to continue to constrain economic activity over the projection period. Real GNP is projected to show little change until the latter half of 1982, when the second stage of the personal tax reduction program goes into effect. On balance, output is expected to rise about 1-1/2 percent over the four quarters of 1982. This sluggish growth in real activity is expected to limit employment opportunities, and the jobless rate is projected to reach 8-1/4 percent by the end of next year.

Restrictive financial conditions are expected to cut most heavily into outlays for investment goods. New housing starts are projected to remain close to a 1 million unit rate through the end of this year and to improve to only about 1-1/4 million units in 1982, in spite of the strength of underlying demographic demands. In the business sector, real outlays are anticipated to trend down throughout the projection period, reflecting a sizable margin of unused capacity and the high real cost of capital. The new business tax provisions, when considered along with the high cost of financing, are expected to have little visible impact on capital spending during the projection period. In consumer markets, outlays for new autos and other durables are likely to be constrained by relatively slow income growth and taut financial conditions.

Inflation is expected to continue close to the recent pace over the remainder of this year. Energy prices are assumed to remain soft for a few more months and, thereafter, to rise 1 to 2 percentage points faster than the overall inflation rate. Food prices are projected to increase rapidly over the remainder of the year reflecting underlying cost pressures and tightening supplies of red meats. Excluding food and energy, prices are expected to decelerate gradually. Moreover, by 1982, sustained slack in labor and product markets and smaller catch-up increases for past inflation as well as the benefits of dollar appreciation should hold down the rate of advance in wages and reduce pressures on prices. As a result, the increase in the GBP fixed-weighted price index is projected to slow from an 8 percent annual rate in the second half of this year to a 7-1/4 percent annual rate by the latter half of 1982.

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

STAFF GNP PROJECTIONS

Percent changes, annual rate											
Nominal GNP		Real GNP		Gross domestic business product fixed-weighted price index				Unemployment rate (percent)			
				Total		Excluding food and energy					
7/1/81	8/12/81	7/1/81	8/12/81	7/1/81	8/12/81	7/1/81	8/12/81	7/1/81	8/12/81		
Annual changes:											
1979	<u>1/</u>	12.0	12.0	3.2	3.2	9.7	9.7	8.4	8.4	5.8	5.8
1980	<u>1/</u>	8.8	8.8	-.2	-.2	9.8	9.8	8.7	8.7	7.1	7.1
1981	<u>1/</u>	11.6	11.1	2.6	2.1	9.3	9.1	8.7	8.8	7.6	7.3
1982		8.3	7.9	.8	.6	8.0	7.6	7.7	7.4	8.2	8.0
Quarterly changes:											
1980-Q1	<u>1/</u>	12.6	12.6	3.1	3.1	10.1	10.1	7.4	7.4	6.2	6.2
1980-Q2	<u>1/</u>	-1.1	-1.1	-9.9	-9.9	9.8	9.8	9.5	9.5	7.3	7.3
1980-Q3	<u>1/</u>	11.8	11.8	2.4	2.4	9.6	9.6	9.3	9.3	7.5	7.5
1980-Q4	<u>1/</u>	14.9	14.9	3.8	3.8	9.3	9.3	8.2	8.2	7.5	7.5
1981-Q1	<u>1/</u>	19.2	19.2	8.6	8.6	10.5	10.5	8.1	8.1	7.3	7.4
1981-Q2	<u>1/</u>	6.5	4.0	.2	-1.9	8.4	7.8	10.0	9.8	7.5	7.4
1981-Q3	<u>1/</u>	7.5	7.1	.3	-.2	8.3	8.0	8.4	9.0	7.7	7.1
1981-Q4		10.3	10.3	<u>1.1</u>	1.0	8.5	8.2	7.8	7.5	7.8	7.5
1982-Q1		7.6	6.9	.4	.3	8.1	7.5	7.4	6.8	8.0	7.7
1982-Q2		7.3	7.1	.2	.3	7.8	7.4	7.3	6.8	8.2	7.9
1982-Q3		8.8	8.8	2.0	2.2	7.6	7.4	7.2	6.8	8.3	8.1
1982-Q4		9.8	10.2	2.3	2.8	7.3	7.0	7.0	6.6	8.3	8.2
Two-quarter changes: ^{2/}											
1980-Q2	<u>1/</u>	5.6	5.6	-3.6	-3.6	9.9	9.9	8.4	8.4	1.4	1.4
1980-Q4	<u>1/</u>	13.3	13.3	3.1	3.1	9.5	9.5	8.8	8.8	.2	.2
1981-Q2	<u>1/</u>	12.6	11.3	4.3	3.2	9.4	9.1	9.1	9.0	.0	-.1
1981-Q4		8.9	8.7	.7	.4	8.4	8.1	8.1	8.2	.3	.1
1982-Q2		7.4	7.0	.3	.3	7.9	7.4	7.3	6.9	.4	.4
1982-Q4		9.3	9.5	2.2	2.5	7.4	7.2	7.1	6.6	.1	.3
Four-quarter changes: ^{3/}											
1979-Q4	<u>1/</u>	9.9	9.9	1.7	1.7	9.7	9.7	8.2	8.2	.1	.1
1980-Q4	<u>1/</u>	9.4	9.4	-.3	-.3	9.7	9.7	8.6	8.6	1.6	1.6
1981-Q4		10.8	10.0	2.5	1.8	8.9	8.6	8.6	8.6	.3	.0
1982-Q4		8.4	8.2	1.2	1.4	7.7	7.3	7.2	6.7	.5	.7

^{1/} Actual.^{2/} Percent change from two quarters earlier.^{3/} Percent change from four quarters earlier.

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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.)

	1979				1980			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross national product	2340.6	2374.6	2444.1	2496.3	2571.7	2564.8	2637.3	2730.6
Final purchases	2316.2	2341.5	2430.8	2497.1	2569.1	2557.4	2653.4	2748.0
Private	1858.0	1876.4	1955.4	2000.7	2052.3	2027.4	2119.9	2189.4
Excluding net exports	1838.1	1868.2	1937.5	1993.1	2044.1	2010.3	2075.4	2166.1
Personal consumption expenditures	1454.1	1478.0	1529.1	1582.3	1631.0	1626.8	1682.2	1751.0
Goods	784.3	793.8	824.8	855.3	882.0	858.4	883.0	926.8
Services	669.9	684.2	704.3	727.0	749.0	768.4	799.2	824.2
Gross private domestic investment	408.3	423.2	421.7	410.0	415.6	390.9	377.1	397.7
Residential construction	116.7	117.2	119.8	120.6	115.2	93.6	99.2	113.0
Business fixed investment	267.3	272.9	288.5	290.2	297.8	289.8	294.0	302.1
Change in business inventories	24.3	33.1	13.3	-8	2.5	7.4	-16.0	-17.4
Nonfarm	20.8	29.2	7.8	-4.4	1.5	6.1	-12.3	-14.0
Net exports of goods and services ^{1/}	19.9	8.2	17.9	7.6	8.2	17.1	44.5	23.3
Exports	259.1	266.8	293.1	306.3	337.3	333.3	342.4	346.1
Imports	239.2	258.6	275.2	298.7	329.1	316.2	297.9	322.7
Gov't. purchases of goods and services	458.2	465.1	475.4	496.4	516.8	530.0	533.5	558.6
Federal ^{2/}	164.8	163.6	165.1	178.1	190.0	198.7	194.9	212.0
State and local	293.4	301.6	310.4	318.3	326.8	331.3	338.6	346.6
Gross national product in constant (1972) dollar	1479.9	1473.4	1488.2	1490.6	1501.9	1463.3	1471.9	1485.6
Personal income	1864.6	1906.3	1972.3	2032.0	2088.2	2114.5	2182.1	2256.2
Wage and salary disbursements	1194.8	1218.6	1248.6	1282.2	1314.7	1320.4	1341.8	1397.8
Disposable personal income	1580.2	1612.8	1663.8	1710.1	1765.1	1784.1	1840.6	1897.0
Saving rate (percent)	5.3	5.6	5.4	4.7	4.9	6.2	6.1	5.1
Corporate profits with I.V.A. and C.C. Adj	201.9	196.6	199.5	189.4	200.2	169.3	177.9	183.3
Corporate profits before tax	253.1	250.9	262.0	255.4	277.1	217.9	237.6	249.5
Federal government surplus or deficit (-) (N.I.A. basis)	-11.5	-8.1	-15.2	-24.5	-36.3	-66.5	-74.2	-67.9
High employment surplus or deficit (-)	-4.6	5.1	-2.3	-7.1	-17.1	-21.5	-21.2	-13.4
State and local government surplus or deficit (-) (N.I.A. basis)	29.5	21.9	26.5	28.9	26.6	23.9	28.6	37.1
Excluding social insurance funds	7.1	-1.7	2.1	4.0	1.3	-1.7	.9	8.1
Civilian labor force (millions)	102.3	102.4	103.2	103.7	104.2	104.7	105.0	105.2
Unemployment rate (percent)	5.8	5.7	5.8	5.9	6.2	7.3	7.5	7.5
Nonfarm payroll employment (millions)	89.0	89.7	90.2	90.5	90.8	90.5	90.2	90.8
Manufacturing	21.0	21.1	21.1	20.9	20.8	20.3	20.0	20.2
Industrial production (1967=100)	152.7	152.3	152.6	152.5	152.5	144.6	142.1	149.1
Capacity utilization: all mfg. (percent)	86.9	85.9	85.3	84.4	83.4	77.9	75.7	79.2
Materials (percent)	88.4	87.5	87.2	86.3	85.5	78.7	74.9	80.0
Housing starts, private (million units, A.R.)	1.64	1.84	1.79	1.59	1.23	1.06	1.39	1.54
New autos sales, (millions, A.R.)	11.56	10.65	10.79	9.80	10.65	7.68	8.80	9.04
Domestic models	9.30	8.16	8.63	7.43	7.87	5.53	6.51	6.57
Foreign models	2.25	2.49	2.16	2.37	2.77	2.14	2.29	2.47

^{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 Accounts table which follows.

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

	1979				1980			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) dollars</u>								
Gross national product	3.9	-1.7	4.1	.6	3.1	-9.9	2.4	3.8
Final purchases	2.5	-2.5	7.2	2.9	3.1	-10.4	4.1	4.4
Private	3.0	-3.0	8.7	2.2	2.2	-13.3	6.5	4.9
Excluding net exports	1.1	-1.6	5.5	1.9	-.4	-14.4	4.6	8.5
Personal consumption expenditures	.9	-1.2	4.7	3.6	.8	-9.8	5.1	7.0
Goods	-2.7	-4.6	6.0	4.2	-.3	-17.7	4.0	10.2
Services	5.5	3.0	3.1	2.8	2.1	.0	6.4	3.7
Gross private domestic investment	10.6	1.7	-9.9	-17.8	-5.6	-28.9	-10.0	11.1
Residential structures	-6.5	-10.8	-3.6	-3.1	-24.2	-60.2	16.0	64.2
Business fixed investment	5.2	-.4	13.4	-5.4	2.2	-19.9	-1.5	4.0
Gov't. purchases of goods and services	.7	-.5	1.2	6.1	6.9	2.5	-5.0	2.2
Federal	8.0	-7.9	-3.6	13.1	18.9	11.9	-13.1	2.0
State and local	-3.3	4.0	3.9	2.4	.6	-2.8	.3	2.3
Disposable personal income	3.1	.5	3.5	.8	1.3	-4.9	4.1	2.9
<u>Current dollars</u>								
Gross national product	12.7	5.9	12.2	8.8	12.6	-1.1	11.8	14.9
Final purchases	11.5	4.4	16.1	11.4	12.0	-1.8	15.9	15.0
Private	12.8	4.0	17.9	9.6	10.7	-4.8	19.5	13.8
Excluding net exports	10.8	6.7	15.7	12.0	10.6	-6.5	13.6	18.7
Personal consumption expenditures	11.0	6.7	14.6	14.7	12.9	-1.0	14.3	17.4
Goods	8.5	4.9	16.6	15.6	13.1	-10.3	12.0	21.4
Services	14.2	8.8	12.2	13.5	12.7	10.8	17.0	13.1
Gross private domestic investment	17.0	15.4	-1.5	-10.6	5.6	-21.8	-13.3	23.7
Residential structures	1.8	1.8	9.1	2.8	-16.7	-56.4	25.7	68.5
Business fixed investment	13.9	8.6	25.0	2.3	11.0	-10.4	6.0	11.5
Gov't. purchases of goods and services	6.3	6.2	9.2	18.8	17.5	10.6	2.6	20.2
Federal	10.7	-2.9	3.7	35.4	29.5	19.8	-7.5	40.2
State and local	3.9	11.6	12.2	10.6	11.2	5.6	9.1	9.7
Disposable personal income	13.5	8.5	13.3	11.6	13.5	4.4	13.3	12.8
Personal income	12.8	9.3	14.6	12.7	11.5	5.1	13.4	14.3
Wage and salary disbursements	13.5	8.2	10.2	11.2	10.5	1.8	6.6	17.8
Corporate profits with IVA & C.C. Adj.	-1.6	-10.1	6.0	-18.8	24.8	-48.9	21.9	12.7
Corporate profits before tax	8.3	-3.4	18.9	-9.7	38.6	-61.8	41.4	21.6
Nonfarm payroll employment	3.7	3.1	2.4	1.2	1.5	-1.6	-1.0	2.7
Manufacturing	3.5	2.1	-.1	-3.6	-2.4	-9.7	-5.9	3.7
Nonfarm business sector								
Output per hour	-.9	-1.6	-1.1	-.2	.3	-2.9	3.6	-.2
Compensation per hour	10.9	10.4	8.6	9.7	10.2	11.3	9.0	9.8
Unit labor costs	11.9	12.1	9.7	9.9	9.9	14.6	5.3	10.1
GNP implicit deflator ^{1/}	8.4	7.8	7.8	8.1	9.3	9.8	9.2	10.7
Gross domestic business product								
fixed-weighted price index ^{2/}								
Excluding food and energy	9.7	9.7	9.5	10.0	10.1	9.8	9.6	9.3
Consumer price index (all urban)	7.5	7.2	6.9	11.1	7.4	9.5	9.3	8.2
Industrial production	5.4	-1.0	.8	-.3	.0	-19.2	-6.7	21.2

^{1/} Excluding Federal pay increases, rates of change were: 1979-Q1, 8.3 percent; 1979-Q4, 7.5 percent; 1980-Q1, 9.2 percent; 1980-Q4, 9.7 percent.

^{2/} Uses expenditures in 1972 as weights.

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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.)

	1981				1982			
	Q1	Q2	Q3	Q4	Projected Q1	Q2	Q3	Q4
Gross national product	2853.0	2881.0	2930.5	3003.6	3054.0	3106.7	3172.8	3250.8
Final purchases	2848.5	2860.6	2916.6	2990.0	3041.2	3096.1	3167.7	3243.7
Private	2272.0	2283.0	2328.4	2384.2	2424.1	2464.0	2521.5	2577.9
Excluding net exports	2242.8	2263.6	2302.2	2355.5	2408.0	2459.1	2526.7	2587.5
Personal consumption expenditures	1810.1	1830.3	1871.7	1924.9	1968.5	2009.7	2066.5	2115.2
Goods	964.3	959.4	977.1	1005.9	1028.5	1049.7	1083.5	1112.8
Services	845.8	870.9	894.6	919.0	940.0	960.0	983.0	1002.4
Gross private domestic investment	437.1	453.8	444.4	444.2	452.3	460.0	465.3	479.4
Residential construction	116.7	111.4	102.4	98.4	103.4	108.9	114.9	121.9
Business fixed investment	315.9	322.0	328.1	332.2	336.1	340.5	345.3	350.4
Change in business inventories	4.5	20.4	13.9	13.6	12.8	10.6	5.1	7.1
Nonfarm	6.8	19.5	13.9	13.6	12.8	10.6	5.1	7.1
Net exports of goods and services <u>1/</u>	29.2	19.4	26.2	28.7	16.1	4.9	-5.2	-9.6
Exports	367.4	366.2	378.1	382.5	383.0	384.6	387.2	391.1
Imports	338.2	346.9	351.9	353.8	366.9	379.7	392.4	400.7
Gov't. purchases of goods and services	576.5	577.6	588.2	605.8	617.1	632.1	646.2	665.8
Federal <u>2/</u>	221.6	219.5	224.0	235.4	240.6	249.5	257.3	270.6
State and <u>3/</u> local	354.9	358.1	364.2	370.4	376.5	382.6	388.9	395.2
Gross national product in constant (1972) dollars	1516.4	1509.1	1508.4	1512.0	1513.0	1514.1	1522.3	1532.9
Personal income	2319.8	2367.8	2432.2	2484.3	2530.2	2574.8	2638.5	2694.5
Wage and salary disbursements	1442.9	1465.9	1492.8	1523.1	1548.2	1573.5	1601.8	1638.9
Disposable personal income	1947.8	1985.4	2037.5	2092.4	2133.0	2170.2	2257.4	2301.1
Saving rate (percent)	4.6	5.3	5.7	5.5	5.2	4.9	6.0	5.6
Corporate profits with I.V.A. and C.C. Adj.	203.0	177.2	172.7	189.0	185.5	187.8	194.1	204.1
Corporate profits before tax	259.1	220.3	210.1	228.2	212.6	211.5	214.4	221.0
Federal government surplus or deficit (-) (N.I.A. basis)	-43.3	-49.6	-67.0	-82.7	-92.4	-100.5	-148.3	-148.5
High employment surplus or deficit (-) <u>3/</u>	3.9	4.7	-3.9	-13.8	-13.8	-14.8	-62.0	-58.6
State and local government surplus or deficit (-) (N.I.A. basis)	37.2	34.7	32.4	31.3	30.7	30.1	31.5	32.5
Excluding social insurance funds	6.7	3.3	.4	-1.3	-2.7	-4.0	-3.4	-3.2
Civilian labor force (millions)	105.8	106.8	106.6	106.9	107.3	107.6	107.9	108.2
Unemployment rate (percent)	7.4	7.4	7.1	7.5	7.7	7.9	8.1	8.2
Nonfarm payroll employment (millions)	91.2	91.5	92.0	91.9	91.9	91.9	92.0	92.2
Manufacturing	20.2	20.4	20.6	20.5	20.5	20.4	20.5	20.6
Industrial production (1967=100)	151.8	152.6	152.5	153.1	153.3	153.6	155.1	156.6
Capacity utilization: all mfg. (percent)	79.9	79.9	79.1	78.8	78.5	78.1	78.2	78.5
Materials (percent)	81.7	81.1	80.5	80.6	80.2	79.8	80.0	80.3
Housing starts, private (million units, A.R.)	1.39	1.17	1.00	1.00	1.15	1.20	1.30	1.35
New autos sales, (millions, A.R.)	9.96	7.89	8.50	8.90	8.40	8.80	9.10	8.85
Domestic models	7.31	5.63	6.20	6.50	6.30	6.50	6.70	6.45
Foreign models	2.66	2.26	2.30	2.40	2.10	2.30	2.40	2.40

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 Accounts table which follows.

3/ Estimates in table are evaluated at a 5.1 percent high employment unemployment rate. Evaluated at a 6.1 percent unemployment rate, the high employment budget would show a deficit of \$37.7 billion in 1980-Q4 and a deficit of \$41.7 billion in 1981-Q4, and a deficit of \$-87.0 billion in 1982-Q4.

August 12, 1981

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

	1981				1982			
	Q1	Q2	Q3	Q4	Projected Q1	Q2	Q3	Q4
<u>Constant (1972) dollars</u>								
Gross national product	8.6	-1.9	-.2	1.0	.3	.3	2.2	2.8
Final purchases	6.9	-4.8	.6	1.0	.4	.6	2.9	2.5
Private	7.3	-4.8	.4	1.3	.2	.2	3.3	2.8
Excluding net exports	6.7	-3.4	.1	2.1	1.8	1.5	4.4	3.3
Personal consumption expenditures	5.8	-1.9	2.4	3.9	1.8	1.3	4.8	3.2
Goods	9.8	-6.2	2.7	4.2	1.8	1.7	7.2	4.8
Services	1.4	3.2	2.0	3.5	1.8	.9	2.2	1.4
Gross private domestic investment	24.2	11.4	-14.2	-6.1	.8	.0	-2.7	5.5
Residential structures	3.6	-20.6	-33.9	-20.7	13.2	14.2	15.1	17.6
Business fixed investment	13.3	-6.1	-1.6	-1.6	-1.2	-9	-6	-2
Gov't. purchases of goods and services	5.4	-4.7	1.4	-.4	1.1	2.2	1.6	1.6
Federal	14.8	-6.4	5.1	.1	4.2	7.3	5.2	5.4
State and local	.2	-3.7	-.8	-.8	-.8	-.9	-.7	-.8
Disposable personal income	3.0	1.3	3.7	3.3	.5	.0	9.7	1.5
<u>Current dollars</u>								
Gross national product	19.2	4.0	7.1	10.3	6.9	7.1	8.8	10.2
Final purchases	15.5	1.7	8.1	10.4	7.0	7.4	9.6	9.9
Private	16.0	2.0	8.2	9.9	6.9	6.8	9.7	9.2
Excluding net exports	14.9	3.8	7.0	9.6	9.2	8.8	11.5	10.0
Personal consumption expenditures	14.2	4.5	9.4	11.9	9.4	8.6	11.8	9.8
Goods	17.2	-2.0	7.6	12.3	9.3	8.5	13.5	11.3
Services	10.9	12.4	11.3	11.4	9.5	8.8	9.9	8.1
Gross private domestic investment	45.9	16.1	-8.0	-.2	7.5	7.0	4.7	12.7
Residential structures	14.0	-16.9	-28.6	-14.7	21.9	23.0	23.9	26.7
Business fixed investment	19.6	7.9	7.8	5.1	4.8	5.3	5.8	6.0
Gov't. purchases of goods and services	13.5	.7	7.5	12.5	7.7	10.1	9.2	12.7
Federal	19.3	-3.7	8.5	22.0	9.1	15.6	13.1	22.3
State and local	10.0	3.6	7.0	7.0	6.8	6.6	6.8	6.6
Disposable personal income	11.2	7.9	10.8	11.2	8.0	7.2	17.0	8.0
Personal income	11.8	8.5	11.3	8.8	7.6	7.2	10.3	8.8
Wage and salary disbursements	13.5	6.5	7.5	8.4	6.8	6.7	7.4	9.6
Corporate profits with IVA & C.C. Adj.	50.4	-41.9	-9.8	43.4	-7.2	5.1	14.1	22.3
Corporate profits before tax	16.3	-47.8	-17.3	39.2	-24.7	-2.0	5.6	12.8
Nonfarm payroll employment	1.8	1.3	2.1	-.4	.0	.0	.4	.9
Manufacturing	.5	4.2	3.8	-1.9	-.6	-.6	.5	2.1
Nonfarm business sector								
Output per hour	4.3	-.9	-2.4	1.8	.7	.7	2.3	2.2
Compensation per hour	11.6	9.6	8.9	8.5	8.9	8.1	7.9	7.9
Unit labor costs hour	7.0	10.6	11.6	6.6	8.1	7.3	5.5	5.6
GNP implicit deflator ^{1/}	9.8	6.0	7.2	9.3	6.6	6.8	6.5	7.2
Gross domestic business product								
fixed-weighted price index ^{2/}	10.5	7.8	8.0	8.2	7.5	7.4	7.4	7.0
Excluding food and energy	8.1	9.8	9.0	7.5	6.8	6.8	6.8	6.6
Consumer price index (all urban)	10.8	7.5	10.2	10.3	9.8	7.1	7.0	6.4
Industrial production	7.4	2.1	-.3	1.6	.5	.8	4.0	3.9

^{1/} Excluding Federal pay increases, the rates of change are: 1981-Q1, 9.7 percent; 1981-Q4, 8.3 percent; 1982-Q1, 6.6 percent; 1982-Q4, 6.3 percent.

^{2/} Uses expenditures in 1972 as weights.

CONFIDENTIAL - FR
CLASS II FOMC

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

	1975	1976	1977	1978	1979	1980	Projected	
							1981	1982
Gross national product	1549.2	1718.0	1918.0	2156.1	2413.9	2626.1	2917.0	3146.1
Final purchases	1556.1	1706.2	1897.0	2133.9	2396.4	2632.0	2903.9	3137.2
Private	1216.2	1344.1	1502.5	1701.3	1922.6	2097.3	2316.9	2496.9
Excluding net exports	1189.4	1330.4	1506.7	1701.9	1909.2	2074.0	2291.0	2495.3
Personal consumption expenditures	976.4	1084.3	1205.5	1348.7	1510.9	1672.8	1859.3	2040.0
Goods	539.5	598.5	657.8	729.1	814.5	887.6	976.7	1068.6
Services	437.0	485.7	547.7	619.6	696.3	785.2	882.6	971.3
Gross private domestic investment	206.1	257.9	322.3	375.3	415.8	395.3	444.9	464.2
Residential construction	55.3	72.0	95.8	111.3	118.6	105.3	107.2	112.3
Business fixed investment	157.7	174.1	205.5	242.0	279.7	296.0	324.6	343.1
Change in business inventories	-6.9	11.8	21.0	22.2	17.5	-5.9	13.1	8.9
Nonfarm	-10.5	13.9	20.2	21.8	13.4	-4.7	13.5	8.9
Net exports of goods and services ^{1/}	26.8	13.7	-4.2	-6	13.4	23.3	25.9	1.5
Exports	154.9	170.9	183.3	219.8	281.3	339.8	373.6	386.5
Imports	128.1	157.1	187.5	220.4	267.9	316.5	347.7	384.9
Gov't. purchases of goods and services	339.9	362.1	394.5	432.6	473.8	534.7	587.0	640.3
Federal ^{2/}	122.7	129.2	143.9	153.4	167.9	198.9	225.1	254.5
State and local	217.2	232.9	250.6	279.2	305.9	335.8	361.9	385.8
Gross national product in constant (1972) dollars	1233.9	1300.4	1371.7	1436.9	1483.0	1480.7	1511.5	1520.6
Personal income	1265.0	1391.2	1538.0	1721.8	1943.8	2160.2	2401.0	2609.5
Wage and salary disbursements	806.4	889.9	983.8	1105.2	1236.1	1343.7	1481.2	1590.6
Disposable personal income	1096.1	1194.4	1311.5	1462.9	1641.7	1821.7	2015.8	2215.4
Saving rate (percent)	8.6	6.9	5.6	5.2	5.2	5.6	5.3	5.5
Corporate profits with I.V.A. and C.C. Adj.	110.5	138.1	164.7	185.5	196.8	182.7	185.5	192.9
Corporate profits before tax	132.1	166.3	192.6	223.3	255.4	245.5	229.5	214.9
Federal government surplus or deficit (N.I.A. basis)	-69.3	-53.1	-46.4	-29.2	-14.8	-61.2	-60.9	-122.4
High employment surplus or deficit (-)	-29.2	-20.1	-23.0	-15.7	-2.2	-18.3	-2.3	-37.3
State and local government surplus or deficit (-) (N.I.A. basis)	5.5	16.6	28.1	29.0	26.7	29.1	33.9	31.2
Excluding social insurance funds	-7.6	.9	10.1	9.0	2.9	2.1	2.3	-3.3
Civilian labor force (millions)	92.6	94.8	97.4	100.4	102.9	104.7	106.5	107.7
Unemployment rate (percent)	8.5	7.7	7.0	6.0	5.8	7.1	7.3	8.0
Nonfarm payroll employment (millions)	76.9	79.4	82.5	86.7	89.8	90.6	91.7	92.0
Manufacturing	18.3	19.0	19.7	20.5	21.0	20.3	20.4	20.5
Industrial production (1967=100)	117.8	130.5	138.1	146.1	152.5	147.1	152.5	154.6
Capacity utilization: all manufacturing (percent)	72.9	79.5	81.9	84.4	85.6	79.1	79.5	78.3
Materials (percent)	73.4	81.1	82.7	85.6	87.4	79.8	81.0	80.1
Housing starts, private (million units, A.R.)	1.16	1.54	1.99	2.02	1.75	1.29	1.14	1.25
New auto sales, (millions, A.R.)	8.66	10.12	11.13	11.28	10.70	9.04	8.81	8.79
Domestic models	7.08	8.63	9.07	9.29	8.38	6.62	6.41	6.49
Foreign models	1.58	1.50	2.06	1.99	2.32	2.42	2.41	2.30

^{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.

CONFIDENTIAL - FR
CLASS II FOMC

PERCENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1975	1976	1977	1978	1979	1980	Projected	
							1981	1982
<u>Constant (1972) dollars</u>								
Gross national product	-1.1	5.4	5.5	4.8	3.2	-.2	2.1	.6
Final purchases	.3	4.2	5.2	4.7	3.5	.7	1.5	.7
Private	-.1	5.3	6.0	15.4	4.0	.2	1.8	.7
Excluding net exports	-.6	6.2	6.5	5.2	2.9	-1.0	2.3	1.7
Personal consumption expenditures	2.2	5.6	4.9	4.7	2.9	.5	2.9	2.4
Goods	1.3	6.7	5.2	4.2	1.9	-1.4	2.8	2.7
Services	3.3	4.3	4.5	5.4	4.1	2.6	2.9	2.1
Gross private domestic investment	-20.8	19.2	15.7	7.6	1.3	-12.5	3.6	-2.2
Residential structures	-12.5	21.3	18.5	2.9	-5.2	-18.6	-4.6	-2.8
Business fixed investment	-12.1	5.3	11.9	9.1	6.5	-3.0	.8	-1.4
Gov't. purchases of goods and services	2.1	.0	2.1	2.0	1.5	2.9	.5	.8
Federal	.8	-.7	4.1	-.9	1.9	6.3	2.1	3.6
State and local	2.9	.5	.9	3.7	1.2	1.0	-.5	-1.0
Disposable personal income	2.0	3.6	3.6	4.4	3.1	.7	2.4	2.6
<u>Current dollars</u>								
Gross national product	8.0	10.9	11.6	12.4	12.0	8.8	11.1	7.9
Final purchases	9.6	9.6	11.2	12.5	12.3	9.8	10.3	8.0
Private	9.0	10.5	11.8	13.2	13.0	9.1	10.5	7.8
Excluding net exports	7.9	11.8	13.3	12.9	12.2	8.6	10.5	8.9
Personal consumption expenditures	9.9	11.1	11.2	11.9	12.0	10.7	11.2	9.7
Goods	9.0	10.9	9.9	10.8	11.7	9.0	10.0	9.4
Services	11.1	11.2	12.7	13.1	12.4	12.8	12.4	10.1
Gross private domestic investment	-9.9	25.1	25.0	16.5	10.8	-4.9	12.5	4.4
Residential structures	-4.7	30.2	33.1	16.1	6.6	-11.3	1.9	4.7
Business fixed investment	.8	10.3	18.1	17.7	15.6	5.8	9.7	5.7
Gov't. purchases of goods and services	11.8	6.5	8.9	9.7	9.5	12.9	9.8	9.1
Federal	10.6	5.3	11.4	6.6	9.5	18.5	13.2	13.0
State and local	12.5	7.3	7.6	11.4	9.6	9.8	7.8	6.6
Disposable personal income	9.8	9.0	9.8	11.5	12.2	11.0	10.7	9.9
Personal income	8.2	10.0	10.6	12.0	12.9	11.1	11.1	8.7
Wage and salary disbursements	5.3	10.4	10.6	12.3	11.8	8.7	10.2	7.4
Corporate profits with IVA & C.C. Adj.	16.5	25.0	19.3	12.6	6.1	-7.2	1.5	4.0
Corporate profits before tax	-3.3	25.9	15.8	15.9	14.4	-3.9	-6.5	-6.4
Nonfarm payroll employment	-1.7	3.2	3.9	5.1	3.6	.8	1.2	.4
Manufacturing	-8.8	3.7	3.6	4.2	2.6	-3.5	.5	.3
Nonfarm business sector								
Output per hour	2.1	3.2	2.0	-.2	-.7	-.3	.9	.7
Compensation per hour	9.4	9.6	8.1	7.6	9.7	9.9	10.0	8.5
Unit labor costs	7.4	4.7	5.5	8.7	10.4	10.3	9.0	7.7
GNP implicit deflator	9.6	5.2	5.8	7.3	8.5	9.0	8.8	7.2
Gross domestic business product								
fixed-weighted price index ^{1/}	9.2	5.5	6.3	7.8	9.7	9.8	9.1	7.6
Excluding food and energy	9.2	6.0	6.5	7.5	8.4	8.7	8.6	6.8
Consumer price index (all urban)	9.1	5.8	6.5	7.7	11.3	13.5	9.7	7.6
Industrial production	-8.9	10.8	5.8	5.8	4.4	-3.5	3.7	1.4

^{1/} Uses expenditures in 1972 weights.

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

	Fiscal Year* 1980	FY 1981e/ Admin. F.R.		FY 1982e/ Admin. F.R.		CY 1980*	CY 1981e/ F.R.		FRB Staff Estimates Calendar quarters, unadjusted data								
		1/ Board		1/ Board			F.R. Board	F.R. Board	1980			1981			1982		
									IV*	I*	II*	III	IV	I	II	III	
Unified budget receipts	520.0	605.6	603.7	662.4	642.0	533.0	621.0	127.0	135.2	183.7	157.8	144.4	147.2	193.8	156.7		
Unified budget outlays	579.6	661.2	663.1	704.8	729.9	601.1	692.0	160.6	167.3	167.4	167.8	189.4	165.2	187.1	188.1		
Surplus(+)/deficit(-), unified budget	-59.6	-55.6	-59.4	-42.5	-87.9	-68.1	-71.0	-33.6	-32.1	16.3	-10.0	-45.0	-18.0	6.7	-31.4		
Surplus(+)/deficit(-), off-budget agencies 2/	-14.2	-24.0	-22.5	-18.2	-18.0	-15.3	-22.6	-2.2	-6.4	-5.5	-8.4	-2.4	-4.7	-5.7	-5.2		
Combined deficit to be financed	-73.8	-79.6	-81.9	-60.7	-105.9	-83.4	-93.6	-35.8	-38.5	10.8	-18.4	-47.4	-22.7	1.0	-36.6		
Means of financing combined deficits:																	
Net borrowing from public	70.5	71.0	74.6	59.0	100.9	79.3	81.5	27.7	35.8	-2.6	13.7	34.6	24.2	5.0	37.1		
Decrease in cash operating balance	3.2	6.0	4.6	0.0	1.4	3.6	1.3	8.7	1.6	-5.7	0.0	5.4	3.0	-4.0	-3.0		
Other 3/	0.1	2.6	2.7	1.7	3.4	0.5	10.7	-0.6	1.1	-2.5	4.7	7.4	-4.5	-2.0	2.5		
Cash operating balance, end of period	21.0	15.0	16.4	15.0	15.0	12.3	11.0	12.3	10.7	16.4	16.4	11.0	8.0	12.0	15.0		
Memo: Sponsored agency borrowing 4/	21.4	18.2	33.8	24.9	27.1	24.3	33.9	9.0	3.6	9.7	11.5	9.1	6.0	6.0	6.0		
NIA Budget										Seasonally adjusted annual rates							
Receipts	527.3	620.8	610.2	678.3	634.8	540.8	624.5	573.2	620.7	619.5	627.3	630.6	637.0	645.7	625.9		
Expenditures	578.2	667.3	667.2	719.3	740.8	602.0	685.3	641.1	664.0	669.4	694.3	713.3	729.3	746.2	774.2		
Purchases	190.2	219.3	219.3	247.4	245.7	198.9	225.1	212.0	221.6	219.5	224.0	235.4	240.6	249.5	257.3		
Defense	126.1	147.0	146.8	171.7	170.9	131.7	152.1	141.6	145.2	148.1	152.3	162.7	167.7	173.8	179.5		
Nondefense	64.1	72.3	72.5	75.7	74.8	67.2	73.1	70.4	76.4	71.4	71.7	72.7	72.9	75.7	77.8		
All other expenditures	388.0	448.0	447.9	471.9	495.1	403.1	460.2	429.1	442.4	449.9	470.3	477.9	488.7	496.7	516.9		
Surplus(+)/deficit(-)	-50.9	-46.5	-57.0	-41.0	-106.0	-61.2	-60.7	-67.9	-43.3	-49.9	-67.0	-82.7	-92.4	-100.5	-148.3		
High Employment (H.E.) surplus(+)/deficit(-) evaluated at H.E. unemployment rate of:																	
5.1 percent	-16.7	n.a.	-2.1	n.a.	-26.1	-18.3	-2.3	-13.3	3.9	4.7	-3.9	-13.8	-13.8	-14.8	-62.0		
6.1 percent	-39.5	n.a.	-27.9	n.a.	-54.3	-41.7	-28.9	-37.7	-21.6	-21.3	-31.0	-41.7	-42.1	-43.4	-89.8		
		*--actual		e--estimated			n.a.--not available.										

1. OMB Mid-Session Review of the 1982 Budget, July 1981. In its report on the First Concurrent Resolution for FY 1982; the Congress recommended receipts of \$657.8 billion and outlays of \$695.5 billion. The revised Budget Resolution for FY 1981 recommended receipts of \$603.3 billion and outlays of \$661.4 billion.

2. Includes Federal Financing Bank, Postal Service Fund, Rural Electrification and Telephone Revolving Fund, and Rural Telephone Bank.

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

4. FRB staff estimates includes Federal Home Loan Banks, FHMA, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives marketable debt on an offerings basis.

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

Summary. The backup in market interest rates which began around mid-June continued into early August, carrying bond yields to record levels. Most recently, short- and long-term interest rates have generally come down somewhat from their early August highs, but generally still remain well above their levels at the time of the July FOMC meeting.

The forces influencing interest rate levels seem to have been largely expectational in nature. Rates have remained high in the face of decelerating inflation and a slackening in economic activity, as participants seem to have become more sensitive to the implications of the System's monetary targets for future financial market conditions. And against this background, the low monetary growth targets announced by the Chairman appeared to intensify the market's more bearish outlook. Concerns about future credit market pressures also were intensified as the market focused on the Treasury's large prospective borrowing requirements. The staff expects the Treasury to raise about \$37 billion in the market during the fourth quarter.

In response to the further rise of long-term borrowing costs, business firms cut back sharply on their public bond offerings. Also, private placements are estimated to have remained relatively low--reflecting not only resistance to high yields but also limited availability of lendable funds at life insurance companies. Stock offerings have also dropped off a bit in recent weeks. Business demands on short-term sources of funds, on the other hand, remained comparatively robust, as a step-up in business loan growth at banks--due in only a small way to corporate take-over activity--partially offset a sharp drop in issuance of nonfinancial commercial paper.

With bond yields rising and with thrifts experiencing an outflow of deposits and continuing severe earnings pressures, mortgage market conditions have tightened further in recent weeks. This was reflected by about a 1/2 percentage point rise to 17.13 percent in rates set on commitments for fixed-rate, level-payment mortgages. Against this background and with outstanding mortgage commitments having edged down again in June, growth of household mortgage indebtedness no doubt remained relatively weak in July. Growth in consumer installment credit was probably on the moderate side again in July, judging from the lending activities of weekly reporting banks and the continued weakness of automobile sales.

In the government sector, borrowing by the federal government increased sharply as the budget shifted back into substantial deficit in July. Long-term borrowing by states and localities held up well, but short-term borrowing dropped off rather sharply.

M1-B expanded at a 3-1/4 percent annual rate in July, following declines in the two preceding months. Reflecting this pickup and a strengthening of its nontransactions component--mainly a step-up in growth of MMMFs--M2 increased at about an 8-1/4 percent annual rate. Growth in M3, on the other hand, slowed somewhat as its large CD component moderated and term RPs declined. Despite the strong advance in business loans, July growth in total loans at commercial banks remained relatively slow, and bank credit increased at only a 5 percent annual rate over the month.

Outlook. With inflation providing impetus for continued appreciable growth in nominal GNP, demands for money and credit through late summer and early fall are expected to continue to press on limited supplies. Under these conditions short-term rates will likely fluctuate around their recent

levels. Long-term bond yields may remain volatile, edging a bit lower on balance if the extremely bearish market sentiment that has marked the past month or so is dissipated by incoming evidence of growing economic slack.

Borrowing by the Treasury will be increasing most rapidly in coming months, as its financing needs grow progressively larger on into the fall. Borrowing by states and localities is also expected to remain sizable.

In the household sector, on the other hand, credit flows will likely remain relatively weak. The thrifts are expected to continue to suffer substantial earnings pressures, which will contribute to market conditions adverse to the formation of residential mortgage debt. High interest rates and reduced income growth also are expected to depress borrowing to finance purchases of consumer durable goods, especially automobiles.

Business demands for credit may remain about in line with recent months, as firms continue to tap external funds to fill a fairly wide financing gap. As in the past, any significant market rally will probably elicit a quick effort to fund short-term indebtedness, a practice that will tend to damp any declines in bond yields.

Summary. The weighted-average exchange value of the dollar has spurted a further 4-1/2 percent since July 1, bringing the total appreciation since a year ago to over 30 percent. The appreciation after adjustment for relative changes in consumer prices has been about the same. In the period since July 1 the appreciation of the dollar has ranged from about 5 percent against the mark and pound to about 2 percent against the yen and Canadian dollar. The main factor underlying the recent surge of the dollar is probably greater conviction in the market that U.S. monetary policy would remain firm, together with a view that U.S. economic policy is on a clear-cut course while there are relatively confused signals elsewhere. Political difficulties in Europe are also having some effect.

. There was no U.S. intervention.

On balance, economic activity in foreign industrial countries remains weak. After registering a fairly strong first quarter gain in GNP, activity in both Germany and Japan moderated considerably in the second quarter. In France industrial production has been declining for the past year; in the United Kingdom the decline in activity that began early in 1980 may have been arrested, but there are no signs of actual upturn. In Canada, where growth had been strengthening in recent quarters, there are no some indications of weakening activity.

Macroeconomic policy generally has remained restrictive in the major foreign industrial countries. The German government recently began the process of cutting back on its spending and borrowing plans for 1982. An exception to this general pattern is France, where the new government has switched to somewhat more expansionary policies than its predecessor.

Depressed domestic economic activity, coupled with the appreciation of the dollar, has brought improvements in the trade balances of Japan, Germany, and France, and the Japanese current account moved into surplus in the second quarter.

The U.S. merchandise trade deficit rose from \$18 billion in the first quarter to \$28 billion in the second (SAAR). Exports declined 1 percent -- largely because of a decline in agricultural exports from an especially high first quarter. Imports were up 2-1/2 percent, reflecting a \$1 per barrel increase in the oil price early in the quarter (volume was down slightly), and larger imports of steel and of autos from Canada.

Changes in the foreign positions of U.S. banking offices in July-August reflect primarily the increased demand for dollar-denominated assets, and placement of funds derived from loans related to the Mobil takeover bid. In July, as market demand for dollar assets rose, there was a resumption of heavier foreign intervention. The resulting addition to the supply of Eurodollar deposits probably led to an increase in U.S. banks' foreign borrowing. At the end of July the supply of dollars in foreign offices was enhanced by the placement in that market of the proceeds of the Mobil loan, which was primarily booked at

foreign offices. U.S. non-bank residents' holdings of Eurodollars assets rose by \$17 billion in the December-May period; data for overnight deposits suggest a levelling off of these accounts until some of the proceeds of the Mobil loan were deposited at the end of July.

Among other private capital transactions, foreign net purchases of U.S. stocks averaged nearly \$1 billion per month in May and June; the six-month total of \$4.3 billion was about equal to the total inflow in 1980.

Outlook. Although there have been some changes in individual elements of the U.S. current account in the past month, the over-all profile has not changed significantly. A small current-account surplus for 1981 is expected to shift to sizable deficits in 1982, reaching nearly a \$40 billion annual rate by the fourth quarter and averaging about \$25 billion for the year. The principal changes in underlying factors are an upward shift in the average value of the dollar, tending to raise the deficit, offset by the effects of somewhat slower U.S. growth this year than in the earlier projection and a more pronounced downward drift of the trend in U.S. oil consumption. The surplus in non-trade accounts is projected to decline somewhat more over the projection period than expected earlier, mainly because of the higher value of the dollar.

The weakness evident in economic activity in other major industrial countries is projected to shift gradually to a slow recovery later this year and into 1982. Part of the recovery would be related to gains in exports stemming from their added competitive edge against dollar-priced goods, and consumer demand is also expected to recover

from present depressed levels. Barring adverse political developments abroad, a sustained further appreciation of the dollar seems unlikely, i.e., the market has probably made most of the adjustment to the outlook for economic policy in the United States. It remains the view of the staff that as large U.S. trade and current account deficits become apparent, much of the rise in the dollar over the past few months will be reversed.

CONFIDENTIAL (FR)
CLASS II FOMC

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

August 12, 1981

	1980 ANN.	1981 ANN.	1982 ANN.	1981 Q I	1981 Q II	1981 Q III	1981 Q IV	1982 Q I	1982 Q II	1982 Q III	1982 Q IV
1. GNP NET EXPORTS											
CURRENT \$, NET	23.3	25.9	1.5	29.2	19.3	26.2	28.7	16.1	4.9	-5.2	-9.6
EXPORTS OF G&S	339.8	373.6	386.5	367.4	366.2	378.1	382.5	383.0	384.6	387.2	391.1
IMPORTS OF G&S	316.5	347.7	384.9	338.2	346.9	351.9	353.8	366.9	379.7	392.4	400.7
CONSTANT 72 \$, NET	52.0	47.2	35.6	50.9	46.0	46.9	44.8	40.2	36.5	33.4	32.3
EXPORTS OF G&S	161.1	163.2	159.7	162.5	160.3	165.0	165.0	162.6	160.4	158.6	157.3
IMPORTS OF G&S	109.1	116.0	124.1	111.6	114.3	118.1	120.1	122.4	124.0	125.2	125.1
TERMS OF TRADE (1972=100) 1/	72.7	76.4	78.1	74.6	75.3	76.9	78.7	78.6	78.3	77.9	77.6
2. U.S. MERCHANDISE TRADE BALANCE 2/											
EXPORTS (EXCL. MILITARY)	224.0	242.5	236.9	244.5	241.5	243.2	240.9	238.0	236.4	236.2	237.1
AGRICULTURAL	42.2	46.4	50.2	50.9	43.4	45.3	46.0	48.1	49.5	51.1	52.3
NONAGRICULTURAL	181.7	196.1	186.7	193.5	198.2	197.9	194.9	190.0	186.9	185.2	184.8
IMPORTS	249.3	266.1	285.8	262.9	269.5	267.7	264.5	273.2	281.6	291.0	297.4
PETROLEUM AND PRODUCTS	78.9	81.4	76.3	83.3	84.9	82.1	75.4	74.7	75.8	77.2	77.5
NONPETROLEUM	170.4	184.8	209.5	179.6	184.6	185.7	189.1	198.4	205.8	213.8	219.9
3. U.S. CURRENT ACCOUNT BALANCE											
OF WHICH: NET INVESTMENT INCOME	3.7	5.7	-25.5	12.3	1.3	4.7	4.4	-9.5	-21.6	-32.8	-38.3
	32.8	34.9	29.7	35.5	34.7	35.1	34.3	32.1	29.8	28.3	28.5
4. FOREIGN OUTLOOK - TEN INDUSTRIAL COUNTRIES 3/											