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August 18, 1982

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 to have leveled off, but there is little evidence as yet that a significant recovery is under way. Employment and industrial production showed little movement overall in July. At the same time, retail sales rebounded somewhat from the depressed June level, and housing activity showed signs of improvement, at least in some sectors. However, capital outlays and commitments for new investment spending were still falling through mid-year. Progress continues to be made in reducing underlying cost pressures on prices.

Nonfarm employment was little changed during July. Sizable declines in industrial employment--manufacturing, construction, and mining--were about offset by hiring at trade, finance, and service establishments. The weakness in industrial labor demand partly reflects severe layoffs recently in the energy extraction component of the mining sector as well as at manufacturers of oil- and gas-well drilling equipment. The unemployment rate rose 0.3 percentage point in July to 9.8 percent; however, in recent weeks the average number of new claims for unemployment insurance has moved down a bit.

Industrial production edged down 0.1 percent in July. Production of business equipment continued to decline sharply, while consumer goods output--particularly autos--increased further. Auto assemblies rose 12 percent in July to a 6.6 million unit annual rate, but industry assembly schedules call for about an equivalent reduction in August as new car inventories have backed up on dealers' lots.

The July tax cut and social security cost-of-living increase boosted disposable personal income by an estimated \$36 billion (annual rate) in

July. Nonetheless, consumer spending increased only moderately, with retail sales reportedly rising just 1 percent following the downward revised 3.3 percent drop in June. Part of the July rise in consumer spending reflected a pickup in auto sales, which rose from a 4.8 million unit annual rate in June to a 5-1/4 million unit annual rate in July and early August. Excluding the automotive group, retail sales were up 1/2 percent in July, after declining 1 percent in June.

Total private housing starts jumped nearly 35 percent in July to a 1.2 million unit annual rate--the highest since April 1981. All of the rise was in the multifamily sector and partly reflected an increase in federally-subsidized units. Permits for residential buildings showed a similar picture. Single-family starts were essentially unchanged in July, and sales of both new and existing single-family homes remained weak in June.

Business fixed investment continued to decline through mid-year, and most leading indicators suggest a further contraction in spending. Overall, business fixed investment in real terms fell at an 8-1/2 percent annual rate in the second quarter, with producers' durable equipment down at nearly a 13 percent rate. Signs of further declines ahead include weak orders for nondefense capital goods, a plunge in oil-well drilling, declining construction contracts, and a rise in the vacancy rate for commercial structures.

The book value of manufacturing and trade inventories rose at a \$20 billion annual rate in June, following a sharp reduction in May. Much of the June increase occurred in the auto sector, raising the day's supply of new domestic autos to the highest level since last December. Excluding

autos, the book value of inventories fell at a \$7-1/2 billion annual rate in June, as widespread liquidation at manufacturers more than offset increases at trade establishments. In aggregate, real factory stocks have now been reduced to prerecession levels, but problem areas still exist--particularly at producers of primary metals and electrical machinery.

The general trend of inflation remains below that of recent years, despite increases of 1 percent in the CPI in each of the past two months. Most of the recent surge reflected an acceleration in the volatile energy and homeownership components. Excluding these items, as well as food, consumer prices rose at an annual rate of 7 percent in the second quarter of this year, still well below the 9-1/2 to 10 percent range of 1980 and 1981. Moreover, gasoline prices appear to have leveled off, and recent data on prices of raw agricultural commodities suggest that food price increases may be a bit smaller in coming months.

Decelerating labor cost increases have been an important ingredient in the slowing of inflation, and the further moderation of wage gains seen so far this year should support continued progress. The hourly earnings index for production workers rose at a 6.2 percent annual rate over the first seven months of 1982, compared with increases of 8.4 percent during 1981 and 9.6 percent over the preceding year. A cyclical improvement in productivity during the first half of 1982 also contributed to slower growth in unit labor costs.

Outlook. The projected growth of economic activity in the third quarter has been lowered, with real GNP now expected to rise at a 1 percent annual rate, compared with the 2-1/2 percent rate shown in the last Greenbook. The change in the near-term outlook partly reflects the

recent data that showed less-than-anticipated strength in consumer spending. We expect that this will lead to a more sluggish rise in the production of goods over the near term and a less pronounced slowing in the pace of inventory liquidation.

The staff has altered both the monetary and fiscal policy assumptions underlying the projection. The increase in M1 during the second half of 1982 is assumed to be somewhat larger, consistent with growth around the top of the FOMC's 2-1/2 to 5-1/2 percent target range for 1982. During 1983, growth of M1 still is assumed to be in the upper half of the target range. Short-term interest rates are projected to trend upward over the projection period, but pressures on long-term rates should be tempered by diminishing inflation expectations.

On the fiscal side, calculations based on the new withholding tables suggest that implementation of the July 1, 1982, tax cut led to only an 8-1/2 percent reduction in withholdings, rather than the 10 percent reduction in liabilities called for in the Economic Recovery Tax Act (ERTA). The immediate impact of the tax cut on disposable personal income is now estimated to be \$25 billion (annual rate), \$8 billion less than in the previous Greenbook. For fiscal year 1983, it is now assumed that Congress will enact legislation, effective January 1, 1983, that will raise an additional \$21 billion in revenues during fiscal year 1983, \$6 billion more than assumed in the July Greenbook. The assumptions concerning deficit-reducing expenditure cuts remain unchanged from last month. Reflecting the staff's economic projections and fiscal policy assumptions, the deficit is expected to be \$112 billion in FY 1982, rising to \$159 billion in FY 1983.

Beyond the current quarter, the contour of economic activity remains similar to that shown in previous Greenbooks. Real GNP growth is expected to increase somewhat in the fourth quarter as consumers respond with a lag to the personal income tax cuts, the improvement in housing starts is translated into construction spending, and the cyclical liquidation of inventories draws to a close. At the same time, business investment spending is expected to continue falling, although at a less rapid rate. Nonetheless, the projected rise in real GNP falls far short of the typical cyclical recovery.

Economic activity is projected to continue growing slowly in the first half of 1983. However, the implementation of the third stage of the tax cut next July will add an estimated \$30 billion to disposable income. As a result, consumption outlays are expected to pick up again in the second half of 1983 and provide a boost to real GNP growth. With output rising at a 4 percent annual rate, the demand for capital goods is expected to improve, stemming the slide in business fixed investment.

The moderate pace of activity projected for the next six quarters is likely to generate only small gains in employment as productivity shows a cyclical improvement. Consequently, the unemployment rate is expected to show little improvement, still averaging 9-1/2 percent by the fourth quarter of 1983. The considerable margin of unused capital and labor resources and moderate growth of aggregate demand should permit further progress in bringing down the rate of inflation. The recent slowing of inflation, combined with the wide margin of slack in the labor market, should lead to further reductions in the rate of wage increase and to continued improvement in the outlook for unit labor costs. Prices, as

measured by the fixed-weighted index for gross domestic business product, are expected to rise at a 5-3/4 percent annual rate over the second half of this year, with the rate of increase then slowing to less than 5 percent during 1983.

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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			
	6/23/82	8/18/82	6/23/82	8/18/82	6/23/82	8/18/82	6/23/82	8/18/82	6/23/82	8/18/82
Annual changes:										
1980 <1>	8.8	8.9	-2	-4	9.8	10.1	8.2	8.6	7.1	7.1
1981 <1>	11.4	11.6	2.0	1.9	9.4	9.6	9.2	9.4	7.6	7.6
1982	5.4	4.7	-1.1	-1.6	6.2	6.1	7.0	7.1	9.3	9.5
1983	7.5	7.4	2.5	2.4	5.2	5.1	4.9	5.0	9.4	9.7
Quarterly changes:										
1981 Q1 <1>	19.2	19.6	8.6	7.9	10.5	10.4	8.4	8.4	7.4	7.4
Q2 <1>	4.7	5.3	-1.6	-1.5	8.2	8.6	9.6	9.4	7.4	7.4
Q3 <1>	11.4	11.4	1.4	2.2	9.9	9.3	11.5	11.0	7.4	7.4
Q4 <1>	4.6	3.0	-4.5	-5.3	7.5	7.4	8.2	8.6	8.3	8.3
1982 Q1 <1>	.0	-1.0	-3.7	-5.1	4.7	4.4	5.2	5.3	8.8	8.8
Q2 <1>	6.9	7.1	.7	1.7	3.8	4.3	6.3	6.7	9.5	9.5
Q3	8.3	7.5	2.5	1.0	6.6	6.5	5.8	5.7	9.6	10.0
Q4	8.4	7.6	2.9	2.3	5.7	5.2	5.3	5.0	9.5	9.9
1983 Q1	6.6	7.5	1.9	2.5	5.1	5.4	5.0	5.6	9.5	9.8
Q2	6.5	6.1	2.0	1.9	4.9	4.6	4.6	4.2	9.5	9.8
Q3	8.1	8.1	4.1	4.2	4.5	4.4	4.0	3.9	9.3	9.7
Q4	8.6	8.2	4.0	3.8	4.3	4.2	3.7	3.7	9.1	9.5
Two-quarter changes: <2>										
1981 Q2 <1>	11.7	12.2	3.4	3.1	9.2	9.5	9.0	8.9	-1	-1
Q4 <1>	7.9	7.1	-1.6	-1.6	8.7	8.3	9.8	9.8	.9	.9
1982 Q2 <1>	3.4	3.0	-1.5	-1.8	4.2	4.4	5.6	6.0	1.2	1.2
Q4	8.4	7.5	2.7	1.6	6.1	5.8	5.5	5.4	.0	.4
1983 Q2	6.6	6.8	1.9	2.2	5.0	5.0	4.8	4.9	.0	-1
Q4	8.4	8.1	4.1	4.0	4.4	4.3	3.8	3.8	-4	-3
Four-quarter changes: <3>										
1980 Q4 <1>	9.4	9.4	-.3	-.7	9.7	10.3	8.6	9.4	1.5	1.5
1981 Q4 <1>	9.8	9.6	.9	.7	9.0	8.9	9.4	9.3	.8	.8
1982 Q4	5.8	5.2	.6	-.1	5.2	5.1	5.6	5.7	1.2	1.6
1983 Q4	7.5	7.5	3.0	3.1	4.7	4.6	4.3	4.4	-4	-4

<1> Actual.

<2> Percent change from two quarters earlier.

<3> Percent change from four quarters earlier.

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

	1980				1981			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross national product	2575.9	2573.4	2643.7	2739.4	2864.9	2901.8	2980.9	3003.2
Final purchases	2576.6	2573.9	2664.8	2757.1	2852.7	2877.2	2949.1	2989.9
Private	2057.4	2037.9	2126.3	2197.3	2274.6	2294.0	2348.9	2363.6
Excluding net exports	2043.4	2013.7	2087.3	2173.8	2243.4	2270.3	2323.0	2340.1
Personal consumption expenditures	1618.7	1622.2	1682.0	1745.8	1799.9	1819.4	1868.8	1884.5
Goods	871.4	855.7	886.4	925.2	957.5	960.0	982.5	976.1
Services	747.3	766.6	795.6	820.6	842.4	859.4	886.3	908.3
Gross private domestic investment	424.0	391.0	384.1	410.3	455.7	475.5	486.0	468.9
Residential structures	113.5	91.2	97.6	110.5	113.6	109.5	101.2	95.5
Business fixed investment	311.2	300.2	307.8	317.5	330.0	341.3	353.0	360.2
Change in business inventories	-7	-4	-21.2	-17.7	12.2	24.6	31.8	13.2
Nonfarm	.7	4.0	-15.4	-12.3	10.0	19.3	24.6	6.0
Net exports of goods and services <1>	14.0	24.2	39.0	23.5	31.2	23.7	25.9	23.5
Exports	335.7	337.3	337.2	346.7	365.4	368.9	367.2	367.9
Imports	321.7	313.1	298.2	323.2	334.2	345.1	341.3	344.4
Gov't. purchases of goods and services	519.2	536.0	538.5	559.8	578.1	583.2	600.2	626.3
Federal <2>	189.6	198.8	193.3	207.0	217.0	218.2	230.0	250.5
State and local	329.6	337.2	345.2	352.8	361.1	365.0	370.1	375.7
Gross national product in constant (1972) dollars	1494.9	1457.8	1463.8	1479.4	1507.8	1502.2	1510.4	1490.1
Personal income	2086.8	2109.6	2185.3	2260.0	2330.0	2380.6	2458.2	2494.6
Wage and salary disbursements	1319.7	1332.1	1360.5	1412.2	1452.8	1479.4	1512.3	1531.2
Disposable personal income	1766.9	1781.0	1845.5	1902.9	1958.7	1996.5	2060.0	2101.4
Saving rate (percent)	5.5	6.1	6.1	5.5	5.4	6.1	6.5	7.5
Corporate profits with I.V.A. and G.C. Adj.	195.3	172.2	177.8	181.2	200.3	185.1	193.1	183.9
Corporate profits before tax	268.2	217.6	238.1	245.9	253.1	225.4	233.3	216.5
Federal government surplus or deficit (-) (N.I.A. basis)	-39.7	-67.5	-73.1	-65.2	-39.7	-40.5	-58.0	-101.7
High employment surplus or deficit (-) <3>	-18.3	-20.0	-19.0	-10.5	10.8	22.4	5.3	-21.2
State and local government surplus or deficit (-) (N.I.A. basis)	29.1	23.3	27.1	33.0	31.3	32.9	33.5	29.1
Excluding social insurance funds	3.3	-2.8	-1.0	3.9	1.1	1.7	1.2	-4.2
Civilian labor force (millions)	106.5	106.8	107.2	107.5	108.1	108.8	108.7	109.2
Unemployment rate (percent)	6.3	7.3	7.6	7.5	7.4	7.4	7.4	8.3
Nonfarm payroll employment (millions)	90.9	90.3	89.9	90.5	90.9	91.2	91.4	91.0
Manufacturing	20.9	20.3	19.9	20.1	20.2	20.3	20.3	19.9
Industrial production (1967=100)	152.7	144.5	142.3	148.8	151.8	152.5	153.0	146.3
Capacity utilization: all manufacturing (percent)	83.4	77.9	75.9	79.1	79.9	79.8	79.2	74.8
Materials (percent)	85.8	78.9	75.2	80.1	82.2	81.2	81.2	75.2
Housing starts, private (million units, A.R.)	1.25	1.06	1.39	1.50	1.40	1.17	.96	.87
New auto sales (millions, A.R.)	10.65	7.68	8.80	9.04	9.96	7.89	9.04	7.36
Domestic models	7.87	5.53	6.51	6.57	7.31	5.63	6.90	5.13
Foreign models	2.77	2.14	2.29	2.47	2.66	2.25	2.14	2.23

<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 \$30.7 billion in 1980-Q4, and a deficit of \$43.8 billion in 1981-Q4.

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

	1980				1981			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	1.5	-9.6	1.6	4.3	7.9	-1.5	2.2	-5.3
Final purchases	1.6	-9.6	3.3	3.7	5.4	-4.0	1.0	-2.3
Private	.8	-12.4	5.4	4.7	5.5	-4.0	.4	-4.4
Excluding net exports	-1.3	-13.7	5.7	7.6	4.7	-2.8	2.2	-3.6
Personal consumption expenditures	-.7	-8.7	5.4	5.7	4.4	-2.7	2.9	-3.3
Goods	-2.3	-16.1	5.7	8.6	6.9	-5.1	4.0	-6.2
Services	1.2	.4	5.1	2.6	1.5	.1	1.7	.0
Gross private domestic investment	-4.5	-32.5	-5.1	22.6	25.0	14.9	6.9	-22.6
Residential structures	-21.6	-61.7	20.4	59.8	1.0	-17.4	-31.9	-25.3
Business fixed investment	2.5	-20.4	3.5	6.6	8.0	1.1	9.3	.6
Gov't. purchases of goods and services	5.2	3.1	-4.7	-.3	5.2	-4.1	3.6	7.0
Federal	12.3	10.5	-12.5	-2.6	12.2	-3.2	14.8	20.4
National defense	13.2	.5	-2.5	-2.1	8.0	11.5	7.6	10.1
State and local	1.2	-1.1	.3	1.0	1.3	-4.6	-2.7	-.8
Disposable personal income	1.1	-6.6	5.2	3.0	3.7	.6	4.8	1.2
<u>Current Dollars</u>								
Gross national product	12.2	-.4	11.4	15.3	19.6	5.3	11.4	3.0
Final purchases	11.8	-.4	14.9	14.6	14.6	3.5	10.4	5.7
Private	10.2	-3.7	18.5	14.0	14.8	3.5	9.9	2.5
Excluding net exports	9.5	-5.7	15.6	17.6	13.4	4.9	9.6	3.0
Personal consumption expenditures	10.7	.9	15.6	16.1	13.0	4.4	11.3	3.4
Goods	9.4	-7.0	15.1	18.7	14.7	1.0	9.7	-2.6
Services	12.3	10.7	16.0	13.2	11.1	8.3	13.2	10.3
Gross private domestic investment	7.1	-27.6	-6.8	30.1	52.2	18.5	9.2	-13.3
Residential structures	-14.0	-58.2	31.0	64.5	11.5	-13.4	-27.0	-20.8
Business fixed investment	13.3	-13.3	10.4	13.3	16.7	14.5	14.3	8.4
Gov't. purchases of goods and services	18.5	13.6	1.9	16.8	13.7	3.6	12.2	18.6
Federal	29.5	20.8	-10.5	31.3	20.9	2.2	23.5	40.7
National defense	28.8	10.4	1.7	25.3	15.4	22.1	10.8	36.7
State and local	12.7	9.6	9.8	9.2	9.7	4.4	5.7	6.2
Disposable personal income	12.7	3.2	15.3	13.0	12.3	7.9	13.4	8.3
Personal income	10.7	4.4	15.1	14.4	13.0	9.0	13.7	6.1
Wage and salary disbursements	11.4	3.8	8.8	16.1	12.0	7.5	9.2	5.1
Corporate profits with I.V.A. and C.C. Adj.	29.4	-39.6	13.7	7.9	49.3	-27.1	18.4	-17.7
Corporate profits before tax	34.2	-56.7	43.4	13.8	12.2	-37.1	14.8	-25.8
Nonfarm payroll employment	1.8	-2.3	-1.8	2.7	1.8	1.0	.8	-1.8
Manufacturing	-1.2	-10.4	-7.5	4.2	1.3	2.8	.1	-8.1
Nonfarm business sector								
Output per hour	-.4	-4.6	3.4	3.1	4.9	-1.3	-.3	-3.5
Compensation per hour	11.9	10.2	10.4	9.8	11.8	7.1	9.0	7.3
Unit labor costs	12.4	15.5	6.8	6.5	6.6	8.6	9.3	11.2
GMP implicit deflator <1>	10.5	10.1	9.6	10.5	10.9	6.8	9.0	8.8
Gross domestic business product								
fixed-weighted price index <2>	11.0	10.4	9.9	10.0	10.4	8.6	9.3	7.4
Excluding food and energy	8.7	9.6	9.7	9.7	8.4	9.4	11.0	8.6
Consumer price index (all urban)	16.5	13.5	7.7	12.8	11.0	7.8	11.8	7.7
Industrial production	.4	-19.8	-5.8	19.3	8.4	1.9	1.4	-16.6

<1> Excluding Federal pay increases, rates of change were: 1980-Q1, 10.5 percent; 1980-Q4, 9.4 percent; 1981-Q1, 10.8 percent; 1981-Q4, 7.8 percent.

<2> Uses expenditures in 1972 as weights.

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

	1982				Projected			
					1983			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross national product	2995.5	3047.4	3102.8	3160.2	3218.2	3266.5	3330.7	3396.6
Final purchases	3031.1	3067.0	3109.8	3164.7	3216.2	3261.5	3321.7	3384.6
Private	2401.0	2435.1	2468.9	2506.4	2547.9	2581.9	2630.0	2678.0
Excluding net exports	2369.7	2399.5	2442.6	2493.0	2544.9	2584.1	2635.4	2687.3
Personal consumption expenditures	1919.4	1950.8	1998.8	2044.2	2086.1	2119.1	2163.6	2206.6
Goods	987.0	999.1	1020.5	1041.6	1059.6	1072.1	1091.6	1113.1
Services	932.4	951.6	978.3	1002.6	1026.5	1047.0	1072.0	1093.5
Gross private domestic investment	414.8	429.1	436.8	444.3	460.8	470.0	480.8	492.7
Residential structures	93.4	94.7	98.7	104.0	112.0	116.7	119.2	121.2
Business fixed investment	357.0	354.0	345.1	344.8	346.8	348.3	352.6	359.5
Change in business inventories	-35.6	-19.7	-7.0	-4.5	2.0	5.0	9.0	12.0
Nonfarm	-36.0	-19.2	-7.0	-4.5	2.0	5.0	9.0	12.0
Net exports of goods and services <1>	31.3	35.6	26.3	13.4	3.0	-2.2	-5.4	-9.3
Exports	359.9	360.9	350.4	342.6	343.2	351.6	364.7	378.6
Imports	328.6	325.3	324.1	329.2	340.2	353.8	370.1	387.9
Gov't. purchases of goods and services	630.1	631.9	640.9	658.3	668.3	679.6	691.7	706.6
Federal <2>	249.7	244.1	248.4	261.2	266.6	273.6	281.2	292.1
State and local	380.4	387.8	392.5	397.1	401.7	406.0	410.5	414.5
Gross national product in constant (1972) dollars	1470.7	1476.8	1480.4	1488.8	1498.0	1505.2	1520.6	1534.9
Personal income	2510.5	2549.5	2597.9	2645.8	2693.3	2739.0	2790.3	2837.9
Wage and salary disbursements	1541.6	1555.9	1573.9	1603.9	1629.8	1653.8	1681.1	1714.8
Disposable personal income	2117.1	2151.9	2211.2	2251.6	2291.1	2326.4	2396.2	2433.2
Saving rate (percent)	6.6	6.6	6.9	6.5	6.3	6.2	7.1	6.7
Corporate profits with I.V.A. and C.C. Adj.	157.1	167.0	180.5	185.3	187.2	189.4	203.0	210.8
Corporate profits before tax	171.6	179.2	193.4	192.1	188.1	183.2	189.1	187.3
Federal government surplus or deficit (-) (N.I.A. basis)	-119.3	-116.6	-147.5	-157.4	-148.9	-157.3	-196.1	-199.9
High employment surplus or deficit (-) <3>	-21.2	-8.5	-32.6	-36.0	-18.4	-21.4	-64.9	-68.9
State and local government surplus or deficit (-) (N.I.A. basis)	27.7	29.4	33.1	34.6	36.4	37.7	40.7	44.1
Excluding social insurance funds	-6.8	-6.3	-3.8	-3.5	-2.9	-2.8	-1.0	1.2
Civilian labor force (millions)	109.1	110.2	110.6	110.8	111.1	111.3	111.6	112.0
Unemployment rate (percent)	8.8	9.5	10.0	9.9	9.8	9.8	9.7	9.5
Nonfarm payroll employment (millions)	90.4	90.0	89.8	90.0	90.3	90.5	90.8	91.3
Manufacturing	19.4	19.1	18.8	19.0	19.2	19.4	19.6	19.8
Industrial production (1967=100)	141.7	139.2	138.4	140.6	142.3	144.3	147.9	150.4
Capacity utilization: all manufacturing (percent)	71.6	70.2	69.4	70.3	70.8	71.4	73.0	73.8
Materials (percent)	72.0	69.6	68.8	70.0	70.9	71.9	74.1	75.5
Housing starts, private (million units, A.R.)	.92	.95	1.15	1.15	1.20	1.20	1.20	1.20
New auto sales (millions, A.R.)	8.12	7.53	7.90	8.40	8.60	8.80	9.20	9.20
Domestic models	5.90	5.53	5.60	6.10	6.30	6.50	6.80	6.80
Foreign models	2.22	1.99	2.30	2.30	2.30	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 \$58.7 billion in 1982-Q4, and a deficit of \$93.3 billion in 1983-Q4.

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

	Projected							
	1982				1983			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	-5.1	1.7	1.0	2.3	2.5	1.9	4.2	3.8
Final purchases	.2	-6	-1	2.0	1.8	1.6	3.7	3.5
Private	1.0	.8	-2	1.9	1.9	1.5	4.0	3.9
Excluding net exports	.9	1.2	.8	3.3	3.1	1.7	3.7	3.8
Personal consumption expenditures	2.5	3.0	3.3	4.1	2.9	1.8	4.0	3.7
Goods	2.0	4.1	2.4	4.5	2.7	1.1	3.8	4.3
Services	3.0	1.9	4.3	3.6	3.1	2.5	4.2	3.0
Gross private domestic investment	-36.5	10.9	-3.1	2.0	10.2	3.9	5.9	6.5
Residential structures	-10.2	3.3	13.4	18.5	28.7	12.8	4.3	2.6
Business fixed investment	-5.0	-8.5	-15.3	-4.5	-1.4	-1.6	2.1	4.5
Gov't. purchases of goods and services	-2.9	-6.4	.3	2.2	1.1	2.0	2.5	1.6
Federal	-5.5	-16.1	3.5	8.0	4.8	6.9	7.3	5.3
National defense	-7.9	7.1	6.7	4.6	6.4	11.2	12.1	9.4
State and local	-1.1	.4	-1.7	-1.3	-1.2	-1.2	-7	-9
Disposable personal income	-1.9	3.1	4.5	2.3	1.7	1.6	7.7	1.9
<u>Current Dollars</u>								
Gross national product	-1.0	7.1	7.5	7.6	7.5	6.1	8.1	8.2
Final purchases	5.6	4.8	5.7	7.3	6.7	5.8	7.6	7.8
Private	6.5	5.8	5.7	6.2	6.8	5.4	7.7	7.5
Excluding net exports	5.2	5.1	7.4	8.5	8.6	6.3	8.2	8.1
Personal consumption expenditures	7.6	6.7	10.2	9.4	8.5	6.5	8.7	8.2
Goods	4.5	5.0	8.8	8.5	7.1	4.8	7.5	8.1
Services	11.0	8.5	11.7	10.3	9.9	8.2	9.9	8.3
Gross private domestic investment	-38.8	14.5	7.4	7.0	15.7	8.2	9.5	10.3
Residential structures	-8.4	5.7	17.9	23.3	34.5	17.9	8.8	6.9
Business fixed investment	-3.5	-3.2	-9.7	-3	2.3	1.7	5.0	8.1
Gov't. purchases of goods and services	2.4	1.2	5.8	11.3	6.2	6.9	7.3	8.9
Federal	-1.4	-8.6	7.2	22.3	8.5	10.9	11.6	16.4
National defense	-1.8	15.4	13.1	19.3	11.2	15.7	17.2	21.6
State and local	5.0	8.0	4.9	4.8	4.7	4.4	4.5	4.0
Disposable personal income	3.0	6.8	11.5	7.5	7.2	6.3	12.6	6.3
Personal income	2.6	6.4	7.8	7.6	7.4	7.0	7.7	7.0
Wage and salary disbursements	2.7	3.8	4.7	7.8	6.6	6.0	6.8	8.3
Corporate profits with I.V.A. and C.C. Adj.	-46.7	27.7	36.5	11.0	4.3	4.7	32.0	16.2
Corporate profits before tax	-60.5	18.9	35.7	-2.7	-7.9	-10.1	13.5	-3.8
Nonfarm payroll employment	-2.4	-1.6	-1.0	.7	1.3	1.0	1.6	2.1
Manufacturing	-9.0	-7.2	-5.1	3.7	4.9	3.8	4.3	4.6
Nonfarm business sector								
Output per hour	2.6	2.3	1.0	1.5	2.0	.9	2.3	1.5
Compensation per hour	10.1	6.2	6.1	5.9	6.4	5.5	5.5	5.4
Unit labor costs	7.4	3.8	5.0	4.3	4.3	4.6	3.1	3.8
GNP implicit deflator <1>	4.3	5.3	6.4	5.2	4.9	4.1	3.8	4.2
Gross domestic business product fixed-weighted price index <2>	4.4	4.3	6.5	5.2	5.4	4.6	4.4	4.2
Excluding food and energy	5.3	6.7	5.7	5.0	5.6	4.2	3.9	3.7
Consumer price index (all urban)	3.2	4.6	8.2	4.3	5.5	4.8	4.8	4.6
Industrial production	-11.8	-6.9	-2.3	6.5	4.9	5.7	10.4	6.9

<1> Excluding Federal pay increases, the rates of change are: 1982-Q1, 4.2 percent; 1982-Q4, 4.6 percent; 1983-Q1, 4.9 percent; 1983-Q4, 3.6 percent.

<2> Uses expenditures in 1972 as weights.

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

	1976	1977	1978	1979	1980	1981	---Projected---	
							1982	1983
Gross national product	1718.0	1918.3	2163.9	2417.8	2633.1	2937.7	3076.5	3303.0
Final purchases	1706.2	1895.3	2137.4	2403.5	2643.1	2917.3	3093.1	3296.0
Private	1344.1	1501.5	1705.5	1929.1	2104.7	2320.4	2452.8	2609.4
Excluding net exports	1330.3	1505.5	1706.6	1915.9	2079.5	2294.3	2426.2	2612.9
Personal consumption expenditures	1084.3	1204.4	1346.5	1507.2	1667.2	1843.2	1978.3	2143.8
Goods	598.5	657.0	728.5	813.5	884.7	969.1	1012.0	1084.1
Services	485.7	547.4	618.0	693.7	782.5	874.1	966.2	1059.7
Gross private domestic investment	257.9	324.1	386.6	423.0	402.3	471.5	431.2	476.1
Residential construction	72.0	95.8	111.2	118.6	103.2	104.9	97.7	117.3
Business fixed investment	174.1	205.2	248.9	290.2	309.2	346.1	350.2	351.8
Change in business inventories	11.8	23.0	26.5	14.3	-10.0	20.5	-16.7	7.0
Nonfarm	13.9	21.9	25.4	8.6	-5.7	15.0	-16.7	7.0
Net exports of goods and services <1>	13.8	-4.0	-1.1	13.2	25.2	26.1	26.6	-3.5
Exports	170.9	182.7	218.7	281.4	339.2	367.3	353.4	359.5
Imports	157.1	186.7	219.8	268.1	314.0	341.3	326.8	363.0
Gov't. purchases of goods and services	362.1	393.8	431.9	474.4	538.4	596.9	640.3	686.5
Federal <2>	129.2	143.4	153.6	168.3	197.2	228.9	250.8	278.4
State and local	232.9	250.4	278.3	306.0	341.2	368.0	389.4	408.2
Gross national product in constant (1972) dollars	1298.2	1369.7	1438.6	1479.4	1474.0	1502.6	1479.2	1514.7
Personal income	1391.2	1540.4	1732.7	1951.2	2160.4	2415.8	2575.9	2765.1
Wage and salary disbursements	889.9	983.2	1106.3	1237.6	1356.1	1493.9	1568.8	1669.9
Disposable personal income	1194.4	1314.0	1474.0	1650.2	1824.1	2029.1	2182.9	2361.7
Saving rate (percent)	6.9	5.9	6.1	5.9	5.8	6.4	6.6	6.6
Corporate profits with I.V.A. and C.C.Adj.	138.1	167.3	192.4	194.8	181.6	190.6	172.5	197.6
Corporate profits before tax	166.3	194.7	229.1	252.7	242.4	232.1	184.1	186.9
Federal government surplus or deficit(-) (N.I.A. basis)	-53.1	-45.9	-29.5	-16.1	-61.4	-60.0	-135.2	-175.6
High employment surplus or deficit(-)	-17.4	-20.6	-16.0	-1.8	-17.0	4.3	-24.6	-43.4
State and local government surplus or deficit (-) (N.I.A. basis)	16.6	28.0	30.3	30.4	28.1	31.7	31.2	39.7
Excluding social insurance funds	.9	10.1	10.0	6.6	.9	-.1	-5.1	-1.4
Civilian labor force (millions)	96.2	99.0	102.3	105.0	106.9	108.7	110.2	111.5
Unemployment rate (percent)	7.7	7.1	6.1	5.8	7.1	7.6	9.5	9.7
Nonfarm payroll employment (millions)	79.4	82.5	86.7	89.8	90.4	91.1	90.1	90.7
Manufacturing	19.0	19.7	20.5	21.0	20.3	20.2	19.1	19.5
Industrial production (1967=100)	130.4	138.1	146.1	152.5	147.0	150.9	140.0	146.2
Capacity utilization: all manufacturing (percent)	79.5	81.9	84.4	85.6	79.1	78.4	70.4	72.3
Materials (percent)	81.1	82.7	85.6	87.4	80.0	79.9	70.1	73.1
Housing starts, private (million units, A.R.)	1.54	1.96	2.00	1.72	1.30	1.10	1.04	1.20
New auto sales (millions, A.R.)	10.54	10.69	10.92	9.91	8.34	7.98	8.02	8.95
Domestic models	8.63	9.07	9.29	8.36	6.62	6.24	5.78	6.60
Foreign models	1.92	1.62	1.63	1.55	1.72	1.74	2.24	2.35

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

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

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CLASS II FOMCPERCENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1976	1977	1978	1979	1980	1981	--Projected--	
							1982	1983
<u>Constant (1972) Dollars</u>								
Gross national product	5.4	5.5	5.0	2.8	-.4	1.9	-1.6	2.4
Final purchases	4.2	5.1	4.9	3.5	.5	1.0	-.5	1.7
Private	5.3	6.0	5.6	4.0	.0	1.0	-.6	1.9
Excluding net exports	6.2	6.5	5.5	2.9	-1.1	1.8	.1	2.6
Personal consumption expenditures	5.6	5.0	4.5	2.7	.3	1.8	1.4	3.1
Goods	6.7	5.1	4.2	1.9	-1.5	1.9	.8	3.0
Services	4.3	4.9	4.8	3.7	2.4	1.7	2.1	3.3
Gross private domestic investment	19.2	16.1	10.5	-.2	-11.8	8.3	-12.0	5.0
Residential structures	21.3	18.6	2.8	-5.3	-20.1	-4.9	-10.5	15.2
Business fixed investment	5.3	11.7	12.8	7.3	-2.2	3.6	-3.9	-3.6
Gov't. purchases of goods and services	.0	1.5	2.0	1.3	2.3	.9	-.3	1.1
Federal	-.6	3.7	-.1	1.8	4.3	3.7	1.2	4.5
National defense	-2.3	.8	.4	2.6	4.0	4.9	3.8	8.0
State and local	.4	.2	3.3	1.1	1.1	-.8	-1.3	-1.1
Disposable personal income	3.6	4.0	4.9	2.7	.2	2.5	1.6	3.0
<u>Current Dollars</u>								
Gross national product	10.9	11.7	12.8	11.7	8.9	11.6	4.7	7.4
Final purchases	9.6	11.1	12.8	12.4	10.0	10.4	6.0	6.6
Private	10.5	11.7	13.6	13.1	9.1	10.2	5.7	6.4
Excluding net exports	11.8	13.2	13.4	12.3	8.5	10.3	5.7	7.7
Personal consumption expenditures	11.0	11.1	11.8	11.9	10.6	10.6	7.3	8.4
Goods	10.9	9.8	10.9	11.7	8.8	9.5	4.4	7.1
Services	11.2	12.7	12.9	12.2	12.8	11.7	10.5	9.7
Gross private domestic investment	25.1	25.7	19.3	9.4	-4.9	17.2	-8.5	10.4
Residential structures	30.2	33.1	16.1	6.6	-13.0	1.7	-6.9	20.0
Business fixed investment	10.4	17.9	21.3	16.6	6.5	12.0	1.2	.4
Gov't. purchases of goods and services	6.5	8.8	9.7	9.8	13.5	10.9	7.3	7.2
Federal	5.3	11.0	7.1	9.6	17.1	16.1	9.6	11.0
National defense	3.6	8.0	8.0	11.5	17.5	17.0	14.1	15.4
State and local	7.2	7.5	11.2	9.9	11.5	7.9	5.8	4.8
Disposable personal income	9.0	10.0	12.2	12.0	10.5	11.2	7.6	8.2
Personal income	10.0	10.7	12.5	12.6	10.7	11.8	6.6	7.3
Wage and salary disbursements	10.4	10.5	12.5	11.9	9.6	10.2	5.0	6.4
Corporate profits with I.V.A. and C.C.Adj.	25.0	21.1	15.0	1.3	-6.8	5.0	-9.5	14.5
Corporate profits before tax	25.9	17.1	17.7	10.3	-4.0	-4.3	-20.7	1.5
Nonfarm payroll employment	3.2	3.9	5.1	3.6	.7	.8	-1.2	.7
Manufacturing	3.7	3.6	4.2	2.6	-3.6	-.6	-5.4	2.3
Nonfarm business sector								
Output per hour	3.2	2.2	.6	-1.3	-.9	1.4	.5	1.6
Compensation per hour	8.1	7.5	8.6	9.3	10.2	9.7	7.7	5.9
Unit labor costs	4.7	5.2	8.0	10.7	11.2	8.1	7.2	4.2
GNP implicit deflator	5.2	5.8	7.4	8.6	9.3	9.4	6.4	4.8
Gross domestic business product								
fixed-weighted price index <1>	5.5	6.1	8.0	9.9	10.1	9.6	6.1	5.1
Excluding food and energy	6.1	6.3	7.8	8.6	8.6	9.4	7.1	5.0
Consumer price index (all urban)	5.7	6.5	7.7	11.3	13.5	10.3	6.3	5.3
Industrial production	10.7	5.9	5.8	4.4	-3.6	2.6	-7.2	4.5

<1> Uses expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS

	Fiscal Year 1981*	FY1982e/		FY1983e/2/		CY 1981*	CY1982e/ F.R. Board	FRB Staff Estimates Calendar quarters; unadjusted data								
		Admin. 1/	F.R. Board	Admin. 1/	F.R. Board			1981			1982			1983		
								IV*	I*	II*	III	IV	I	II	III	
Unified budget receipts	599.3	622.1	618.1	646.5	630.0	619.1	615.3	146.0	143.6	178.9	149.7	143.2	143.9	189.8	153.1	
Unified budget outlays	657.2	731.0	730.5	761.5	789.0	691.6	730.1	194.2	167.3	181.4	187.7	193.8	197.2	194.2	203.9	
Surplus/deficit(-), unified budget	-57.9	-108.9	-112.4	-115.0	-159.0	-72.5	-114.8	-48.2	-23.7	-2.5	-38.0	-50.6	-53.3	-4.4	-50.8	
Surplus/deficit(-), off-budget agencies ³	-21.0	-19.3	-17.9	-14.9	-17.3	-22.4	-18.1	-3.6	-2.0	-5.8	-6.7	-3.8	-5.3	-4.1	-4.2	
Combined deficit to be financed	-78.9	-128.2	-130.3	-129.9	-176.3	-94.9	-132.9	-51.8	-25.7	-8.3	-44.7	-54.4	-58.6	-8.5	-54.9	
Means of financing combined deficit:																
Net borrowing from public	79.4	126.7	125.9	126.0	180.4	87.3	144.5	35.6	32.8	8.9	48.6	54.2	54.9	15.8	55.5	
Decrease in cash operating balance	2.3		1.4		-2.1	0.3	-3.0	6.7	-1.0	2.0	-6.3	2.3	2.8	-4.2	-3.0	
Other ⁴	-2.8	(1.4)	3.0	(3.9)	-2.1	7.3	-8.6	9.5	-6.1	-2.7	2.3	-2.1	0.8	-3.1	2.3	
Cash operating balance, end of period	18.7	n.a.	17.3	n.a.	19.4	12.0	15.0	12.0	13.0	11.0	17.3	15.0	12.2	16.4	19.4	
Memo: Sponsored agency borrowing ⁵	35.7	46.6	21.1	50.1	26.8	30.0	23.7	4.0	1.6	9.1	6.4	6.6	5.8	7.3	7.1	
NIA Budget																
								Seasonally adjusted annual rates								
Receipts	615.5	n.a.	615.4	n.a.	640.3	628.2	613.6	625.7	609.0	616.4	610.3	618.8	645.4	655.8	641.2	
Expenditures	666.3	n.a.	736.7	n.a.	805.3	688.2	749.0	727.4	728.3	733.0	758.1	776.4	794.4	813.1	837.3	
Purchases	218.1	n.a.	248.2	n.a.	270.6	228.9	230.9	250.5	249.7	244.1	248.4	261.2	266.6	273.6	281.2	
Defense	146.5	n.a.	170.7	n.a.	194.9	153.7	175.4	166.9	166.2	172.2	177.6	185.6	190.6	197.7	205.7	
Nondefense	71.5	n.a.	77.4	n.a.	75.8	75.2	75.5	83.6	83.5	71.9	70.8	75.6	76.0	75.9	75.5	
All other expenditures	448.2	n.a.	488.5	n.a.	534.7	459.3	498.1	476.9	478.6	488.9	509.7	515.2	527.8	539.5	556.1	
Surplus/deficit(-)	-50.9	n.a.	-121.3	n.a.	-165.0	-60.0	-135.3	-101.7	-119.3	-116.6	-147.8	-157.6	-149.0	-157.3	-196.1	
High Employment (H.E.) surplus/deficit(-) evaluated at H.E. unemployment rate of:																
5.1 percent	7.0	n.a.	-20.9	n.a.	-35.2	4.3	-24.6	-21.2	-21.2	-8.5	-32.6	-36.0	-18.4	-21.4	-64.9	
6.1 percent	-14.7	n.a.	-43.3	n.a.	-58.8	-18.0	-47.1	-43.8	-43.6	-31.2	-54.8	-58.7	-42.0	-45.5	-88.8	
	*--actual			e--estimated				n.a.--not available								

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1. OMB Mid-Session Review of the 1983 Budget, July 1982.
 2. In the First Concurrent Resolution on the Budget -- Fiscal Year 1983, the Congress recommended revenues of \$665.9 billion and outlays of \$769.8 billion.
 3. Includes Federal Financing Bank, Postal Service Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank and (beginning in FY1982) the Strategic Petroleum Reserve.

4. Checks issued less checks paid, accrued items and other transactions.
 5. FRB staff estimates include Federal Home Loan Banks, FHLMC (excluding participation certificates), FNMA (excluding mortgage backed securities), Federal Land Banks, Federal Intermediate Credit Banks for Cooperatives, and Student Loan Marketing Association marketable debt on a payment basis. FRB and Administration estimates are not strictly comparable.

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

DOMESTIC FINANCIAL DEVELOPMENTS

Recent developments. Interest rates have fallen substantially since the last FOMC meeting. Reserve positions of depository institutions eased as M1 failed to grow, and the downward impetus to money market rates was reinforced by three one-half point cuts in the discount rate to 10-1/2 percent by August 13. The federal funds rate declined by about 4-1/2 percentage points to around 10 percent, while short-term market rates in the 3- to 6-month maturity range declined 4 to 5 percentage points. Long-term bond yields have fallen about 1-1/2 percentage points. A steep upward slope has emerged in the term structure of market yields, suggesting continuing concern about the prospects for credit market pressures as large Treasury cash needs compete with growing private demands.

Public sector borrowing has been strong in July and August. The federal budget swung sharply into deficit in July, and the Treasury announced intentions to borrow a record \$50 billion in the third quarter as a whole to finance the current quarter deficit and to increase its cash balance in anticipation of another sizable deficit in the fourth quarter. State and local governments continued to issue a large volume of tax-exempt bonds, particularly mortgage revenue bonds.

Business borrowing in the aggregate has remained sizable. Growth in business loans at banks appears to have slowed in July and early August, but there has been an increase in issuance of commercial paper by nonfinancial firms and some pickup in bond offerings. Overall, nonfinancial corporations have continued to borrow more heavily than might be expected in light of the excess of cash flow relative to outlays for inventories and fixed capital--presumably reflecting the varying experience of individual

firms and industries. Furthermore, new bond offerings have tended to be of shorter maturity than is typically the case suggesting little progress in strengthening corporate balance sheets.

A cautious attitude regarding the strength of the economic upturn was reflected until very recently in a weak stock market. Share prices fell over most of the intermeeting period despite the decline in interest rates. Furthermore, indicators of corporate stress have not improved, and interest rate risk premiums, reflected in quality spreads between lower- and higher-graded commercial paper, have widened some, although remaining well below their peaks in the 1974 recession.

In the household sector, growth of consumer credit in June remained at about the same 5 percent rate as in May, considerably above the depressed first quarter pace. Delinquency rates on consumer installment loans at banks and on auto loans at finance companies fell in the second quarter and personal bankruptcies also declined fairly sharply. Mortgage lending activity has remained weak. Rates on conventional, level-payment, fixed-rate mortgages declined more than 40 basis points since early July and FHA-VA ceiling rates were cut 1/2 percentage point. It is difficult to tell, however, what if any effects recent declines in market rates have had on the rates on innovative mortgage financing arrangements involving home sellers.

On the asset side of private sector balance sheets, the buildup of M1 balances that occurred early this year appears to have continued unwinding during July. M1 showed no growth after two months of decline and moved into the 2-1/2 to 5-1/2 percent target range for 1982. Outflows from other checkable deposits, which contributed to the flatness of M1 in July, were

accompanied by sizable outflows from savings deposits. These outflows were offset by an even larger increase in small-denomination time deposits. Consequently, M2 growth accelerated somewhat in July to 9-1/4 percent (annual rate), as growth in the nontransactions component rose to a 12-3/4 percent annual rate, and M2 remains above the long-run target range. Growth of money market mutual funds also was strong particularly late in July and early in August.

Commercial banks somewhat reduced their use of managed liabilities in the aggregate in August but use of negotiable CDs grew. On balance, the great majority of domestic banks encountered no difficulty in raising funds in the domestic CD market despite some difficulties or adverse rate spreads encountered by a few institutions prominently associated with large loan losses.

Outlook. The staff expects that interest rates will remain around their recent lower levels in the near term but may begin to rise later in the year as the economic expansion proceeds.

Short-term business credit demands are likely to abate as firms' cash flow improves and financing needs are reduced. The decline in long-term bond rates could prompt a sizable volume of bond issuance, however, partially offsetting reduced short-term borrowing as firms restructure their debt. Moreover, some modest strengthening of consumer and mortgage credit demands appears likely. Credit demands of the state and local government sector are likely to remain strong in part because of continued large issuance of mortgage revenue bonds.

The federal sector is expected to borrow about \$55 billion in the fourth quarter of this year, following the \$50 billion issuance of marketable

debt in the current quarter. Although the Treasury was not able to market a long-term bond in the recent mid-quarter refunding because the statutory limitation on long-bond financing had not yet been lifted, it is anticipated that this authority, and removal of the interest rate ceiling on savings bonds, will be enacted as part of the tax bill to be voted on in both houses of Congress this week. Orderly completion of the Treasury financing schedule for the current quarter also requires further action on the debt ceiling before the September 30 end of the fiscal year.

Although financial markets are, in general, continuing to function fairly smoothly, an undercurrent of concern about credit quality is likely to remain. In such an environment, yield spreads between private and Treasury securities and between high- and lower-quality borrowers are likely to remain sizable and could be subject to occasional increases in the event of unanticipated business failures.

Recent Developments. The exchange value of the dollar reached a new post-1970 high in early July, but then eased off moderately to about its level at the last FOMC meeting. Demand for dollars has been strong over the period, despite a considerable drop in interest rate differentials, apparently based primarily on growing concern about economic and political difficulties abroad. These difficulties have included the failure of a large bank in Italy and a large industrial company in Germany, the fighting in the Middle East, and, most recently, the collapse of the Mexican peso.

. The United States purchased minor amounts of yen and German marks in this period.

A major feature of the recent period was the collapse of the Mexican peso, which was selling at 49 per dollar in early August and has fallen below 100 pesos per dollar in a disorganized unofficial market. The Mexican government raised administered prices on certain foods and gasoline early in August, and this seems to have touched off fear of demands for higher wages and a flight from the peso. After the government established a two-tier exchange rate system for the peso the

demand for dollars accelerated, forcing the government to take measures to block the transfer of dollar accounts out of Mexico.

The prolonged period of economic stagnation in foreign industrial countries persisted into the second quarter with little indication that recovery is imminent. Industrial production in the United Kingdom was up a little in the second quarter, but June was negative. In Germany, Japan, and Italy industrial production declined in the second quarter, and production in Canada is far below its 1980 level.

Most large industrial countries have experienced some reduction in inflation in the most recent months, though the inflation rate is still high in several countries. For ten major countries, the CPI rose at an average 8-1/2 percent annual rate in the first half, compared with a rate of about 10-1/2 percent in the same half of 1981.

The U.S. trade deficit in the second quarter of 1982 was about \$20 billion (SAAR), down somewhat from the deficit rates in the first quarter and the last half of 1981. A sharp drop in petroleum imports was the largest factor contributing to this decline, with the volume of oil imports down by 10 percent from the first quarter, and prices down about 5 percent. Imports other than petroleum were tending to rise in the second quarter, as the effect of a strong dollar offset weak domestic demand. Both agricultural and other exports held steady in the second quarter.

With a slightly smaller trade deficit in the second quarter, it is likely that the current account balance registered a surplus somewhat larger than the \$5 billion annual rate in the first quarter.

U.S. banks increased the net balance due to their foreign offices by \$4 billion in June, but then reduced these borrowings by about \$2 billion in July, with a further drop in early August. These flows seem to reflect shifts in relative costs of funding in domestic CDs and the Eurodollar interbank markets. There is no indication that defaults by subsidiaries of an Italian bank, or rumors of losses by Canadian and German banks, have affected the functioning of the interbank market, or that the Eurodollar CD market has experienced any difficulties. Credit extended to U.S. nonbanks by foreign branches of U.S. banks rose slightly in June and by a somewhat large amount in July. Data for Eurodollar holdings of U.S. nonbanks indicate that such holdings rose \$20 billion for the year through May (latest data available), compared with a rise of \$33 billion for the full year 1981.

Outlook. A weak recovery in economic activity abroad is projected during the second half of this year, with growth rates of the foreign G-10 countries averaging only 3 percent by the end of next year. However, this prospect has been clouded by the lack of any consistent signs of recovery, and by the possible shock to confidence if there are widespread failures of industrial and financial concerns.

Primarily because of the higher average value of the dollar in recent months, and over most of the projection period, the U.S. current account balance is now projected to move more rapidly toward deficit than previously expected. The balance is now projected at about zero for 1982, and a deficit of about \$30 billion in 1983. The higher exchange rate reduces exports considerably and raises imports somewhat, compared with the previous projection.

The weighted average exchange value of the dollar is about 8 percent higher at this time than was assumed when the previous projection was made. The staff now expects that the recent strength will dissipate only gradually, but that as the U.S. trade and current accounts register large deficits later this year and during 1983 the dollar's exchange value will drop back to about its level at the beginning of this year.

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CLASS II FOMC

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

	1981	1982 ^f	1983 ^f	1982	1982	1982 ^f	1982 ^f	1983 ^f	1983 ^f	1983 ^f	1983 ^f
	ANN.	ANN.	ANN.	Q I	Q II	Q III	Q IV	Q I	Q II	Q III	Q IV
1. GNP NET EXPORTS											
CURRENT \$, NET	26.4	26.6	-3.5	30.3	35.6	26.3	13.4	2.9	-2.1	-5.4	-9.3
EXPORTS OF G&S	367.4	353.5	359.5	359.9	360.9	350.4	342.6	343.2	351.6	364.7	378.6
IMPORTS OF G&S	341.3	326.8	363.0	328.6	325.3	324.1	329.2	340.2	353.8	370.1	387.9
CONSTANT 72 \$, NET	42.0	33.5	25.8	37.0	35.5	32.7	28.9	25.5	25.0	26.1	26.8
EXPORTS OF G&S	158.4	149.3	146.8	151.7	152.3	148.7	144.5	142.7	144.5	148.1	151.7
IMPORTS OF G&S	116.4	115.8	120.9	114.7	116.8	116.0	115.6	117.3	119.5	122.1	124.9
TERMS OF TRADE (1972=100) 1/	79.0	83.9	81.6	82.9	85.4	84.3	83.3	82.9	82.2	81.2	80.4
2. U.S. MERCHANDISE TRADE BALANCE 2/											
EXPORTS (EXCL. MILITARY)	236.3	214.9	208.5	222.4	222.5	210.3	204.4	204.0	205.2	209.4	215.6
AGRICULTURAL	44.3	42.0	46.3	42.0	42.4	41.1	42.4	44.4	45.4	47.2	48.6
NONAGRICULTURAL	192.0	172.9	162.2	180.4	180.1	169.2	162.0	159.9	159.7	162.2	167.0
IMPORTS	264.1	244.9	273.9	246.7	242.9	241.7	248.2	257.7	267.0	279.0	291.7
PETROLEUM AND PRODUCTS	77.6	56.2	63.5	62.6	53.7	53.0	55.5	59.1	61.9	65.0	67.7
NONPETROLEUM	186.6	188.7	210.4	184.1	189.3	188.8	192.7	198.7	205.1	214.0	223.9
3. U.S. CURRENT ACCOUNT BALANCE											
OF WHICH: NET INVESTMENT INCOME	4.5	-.7	-33.3	4.7	7.8 ^f	-1.7	-13.4	-23.7	-30.3	-36.4	-42.7
	33.0	28.9	32.4	27.9	28.4 ^f	29.6	29.8	29.0	30.8	34.1	35.6
4. FOREIGN OUTLOOK - TEN INDUSTRIAL COUNTRIES 3/											
REAL GNP, % CHANGE, ANNUAL RATES	.5	.7	2.3	.4	.5	1.4	2.4	2.8	2.5	2.6	3.0
CONSUMER PRICES, % CHANGE, ANNUAL RATES	9.7	8.4	7.4	7.9	9.0	7.2	7.7	7.8	6.9	6.7	6.7

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

2/ INTERNATIONAL ACCOUNTS BASIS.

3/ GEOMETRIC WEIGHTS USED TO AGGREGATE FOREIGN REAL GNP AND CONSUMER PRICES -- PERCENT SHARE IN TEN-COUNTRY TOTAL MULTILATERAL TRADE. GERMANY (20.8%), JAPAN (13.6%), FRANCE (13.1%), UNITED KINGDOM (10.9%), CANADA (9.1%), ITALY (9.0%), THE NETHERLANDS (8.3%), BELGIUM (6.4%), SWEDEN (4.2%), SWITZERLAND (3.6%).

f/ PROJECTED.