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March 20, 1985

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee

By the staff of the Board of Governors of the Federal Reserve System

DOMESTIC NONFINANCIAL DEVELOPMENTS

Recent developments. Growth of domestic output appears to have slowed from last quarter's strong pace. Domestic spending advanced briskly in early 1985, particularly in the consumer area. But some of the increase reflected higher sales of imported products; industrial production has been relatively weak in the past few months. Inflation at both the consumer and producer levels remained moderate.

Industrial production declined 0.5 percent in February after small gains in the three previous months. The fall in output last month--attributable only in part to severe weather--was widespread among products and materials. Output of business equipment declined for the second month in a row, and production of nonauto consumer goods also fell. However, auto assemblies averaged around 8-1/2 million units in January and February--up sharply from the pace of the second half of 1984. Overall industrial capacity utilization dropped to 80.7 percent in February, about 2 percentage points below its recent high in July of 1984.

Labor demand grew more slowly in February than in the previous four months, with nonfarm payroll employment expanding by 120,000--less than half the recent average monthly increment. Employment declines in manufacturing and construction, the latter mainly weather-related, offset some of the continued hiring strength in the retail trade and service sectors. The civilian unemployment rate in February edged down 0.1 percentage point to 7.3 percent--little different from the rates prevailing since May of last year.

Consumer spending rose vigorously in early 1985. Total retail sales increased 1-1/2 percent in February after two months of little net change; outlays for discretionary items such as general merchandise, apparel, and furniture and appliances were especially strong. Sales of new autos in January and February averaged 11 million units at an annual rate, the strongest two-month pace since 1979.

Spending on business equipment, however, has decelerated in recent months, after posting spectacular gains over the preceding two years. In January, indicators of equipment spending were mixed, as shipments of nondefense capital goods from domestic producers fell sharply while imports of capital goods surged. New orders for nondefense capital goods at domestic firms--which had been sluggish since mid-1984--also dropped sharply in January; softness in bookings in the past few months has been widespread, with particular weakness in the office and computing machinery category. On the other hand, business outlays for motor vehicles apparently advanced. In addition, expenditures for nonresidential construction continued to rise briskly in January, paced by a large gain in outlays for office and other commercial building, and permits continued to move up. Over all, respondents to the February McGraw-Hill Survey anticipated a 9-1/2 percent increase in nominal plant and equipment outlays for 1985, virtually the same as the November reading.

Investment in business inventories has slowed considerably since last autumn. Although inventory-sales ratios at the factory level generally remain low, firms in a number of industries--including apparel, home goods, metals, and some types of machinery--have continued to adjust output in an

apparent response to sagging orders. At the retail level, stocks at general merchandisers, which had been burdensome late last year, apparently have been brought into better alignment with sales.

Housing activity strengthened somewhat in early 1985, with total private housing starts in January and February averaging 1-3/4 million units at an annual rate. In the single-family market, activity generally has trended higher since autumn. Single-family starts in February were 7 percent above the fourth-quarter average and sales of both new and existing houses rose moderately in January. House prices have continued to rise at approximately the rates observed over the past year; after adjustment for quality advancements, prices of new homes in the fourth quarter were about 5 percent above year-earlier levels.

Recent price and wage data have shown no tendency toward acceleration. The consumer price index was up 0.2 percent in January, as weak petroleum product prices again held down overall consumer prices. Food prices rose 0.2 percent, because lower meat prices offset much of the effect of a freeze-induced price hike for fruits and vegetables. Excluding food and energy, consumer prices rose 0.4 percent in January—a bit more than in the previous two months. With producer prices virtually flat in the first two months of 1985, near-term inflation prospects remain favorable.

Wage inflation leveled off in late 1984 and early 1985, with year-over-year changes in the hourly earnings index fluctuating around the 3 percent mark since last autumn. Wage adjustments remain moderate in all major sectors, although wages of manufacturing workers have grown somewhat faster than those of employees in the service, transportation, and public utilities sectors. Over the four quarters of 1984, output-per-hour in the nonfarm

business sector rose 2-1/2 percent—holding unit labor cost increases to less than 2 percent for the year.

Outlook. The staff estimates that real GNP is rising at about a 3 percent annual rate in the current quarter, compared with a 4.9 percent rise in the fourth quarter. As noted, although private domestic final purchases continue to rise vigorously, these demands are being met in large part out of imports, thereby damping the impetus to domestic production and employment. Prices, as measured by the fixed-weighted price index for gross business product, are expected to rise 3 percent, about the same as in the fourth quarter.

The policy assumptions underlying the staff projection for 1985 are essentially unchanged from the last Greenbook. For monetary policy, M1 growth is assumed to be in the upper part of the Committee's range for this year and to slow in 1986. Interest rates are expected to remain near recent levels this year, but to tend lower in 1986 as a tighter fiscal policy takes hold. For fiscal policy, the staff estimates that the federal budget deficit in the current fiscal year will be \$206 billion on a unified budget basis (for a total deficit of \$218 billion). Assuming the enactment of a deficit reduction package on the order of \$50 billion, the deficit is projected to fall to \$186 billion in fiscal year 1986 (\$191 billion on a total budget basis). The staff's expectation regarding the exchange rate has been revised, with the dollar now projected to peak on a quarterly average basis in the second quarter, and then to decline gradually over the next year-and-a-half.

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

3-1/4 percent this year and 2-1/2 percent next year. Consumer spending, particularly for autos and other durables, is expected to remain robust in 1985, bolstered by continued gains in employment and real income and favorable spending attitudes. Thereafter, advances in household spending are expected to moderate, as increases in employment and income taper off. Growth in business fixed investment is expected to slow considerably from the 1983-84 pace, reflecting a flattening of nonresidential construction by late this year, as well as the deceleration now underway in equipment outlays. Housing starts are expected to average around 1-3/4 million units in 1985 and 1986—about the same as in 1984. In the external sector, the anticipated decline in the foreign exchange value of the dollar should contribute to an upturn in export demand and an appreciable slowing in import growth by 1986.

Given the growth path for real GNP in 1985 and 1986, the staff expects little, if any, pressure on capacity in either product or labor markets. Unemployment is expected to fall below 7 percent later this year but to be essentially unchanged in 1986. On the production side, capacity utilization remains flat over the next two years.

The outlook for inflation in 1985 has improved from the projection in the last Greenbook, and the fixed-weighted price index for gross business product is now expected to rise only about 3-1/2 percent. In large part, the more favorable near-term outlook is attributable to the sustained strength of the dollar on foreign exchange markets. In 1986, prices are projected to rise 4 percent, with the acceleration reflecting mainly the assumed depreciation of the dollar. Increases in unit labor costs are expected to pick up a bit over the next two years as wage gains edge up and productivity growth slows to about trend rates.

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			
		2/6/85	3/20/85	2/6/85	3/20/85	2/6/85	3/20/85	2/6/85	3/20/85	2/6/85	3/20/85
Annual changes:											
1983	<1>	7.7	7.7	3.7	3.7	3.8	3.8	4.6	4.6	9.6	9.6
1984	<1>	10.8	10.9	6.8	6.9	4.0	4.0	4.3	4.3	7.5	7.5
1985		7.2	7.1	3.6	3.6	3.7	3.5	4.3	4.1	6.9	7.0
1986		6.7	6.4	3.0	2.8	3.9	3.8	4.3	4.1	6.6	6.7
Quarterly changes:											
1984	Q1 <1>	14.9	14.9	10.1	10.1	4.2	4.2	3.4	3.4	7.9	7.9
	Q2 <1>	10.7	10.7	7.1	7.1	4.1	4.1	5.4	5.4	7.5	7.5
	Q3 <1>	5.6	5.6	1.6	1.6	4.0	4.0	4.9	4.9	7.4	7.4
	Q4 <1>	6.4	7.8	3.9	4.9	3.3	3.2	3.8	3.8	7.2	7.2
1985	Q1	8.1	7.4	3.8	3.1	3.7	3.1	4.4	3.7	7.2	7.3
	Q2	7.4	6.4	3.6	3.5	3.7	3.5	4.3	4.3	6.9	7.1
	Q3	6.8	6.5	3.5	3.3	3.8	3.5	4.1	3.8	6.8	6.9
	Q4	6.6	6.7	3.3	3.3	3.8	3.7	4.1	3.8	6.7	6.8
I ^r	Q1	6.7	6.2	2.8	2.4	3.8	3.9	4.2	4.1	6.7	6.8
	Q2	6.4	5.9	2.4	2.4	4.0	3.9	4.4	4.1	6.7	6.8
	Q3	6.7	6.6	2.7	2.8	4.3	4.1	4.5	4.4	6.6	6.7
	Q4	7.0	6.8	2.8	2.6	4.5	4.3	4.5	4.4	6.6	6.7
Two-quarter changes: <2>											
1984	Q2 <1>	12.8	12.8	8.6	8.6	4.2	4.2	4.4	4.4	-1.0	-1.0
	Q4 <1>	6.0	6.7	2.7	3.2	3.7	3.7	4.4	4.3	-3	-3
1985	Q2	7.8	6.9	3.7	3.3	3.7	3.3	4.3	4.0	-3	-1
	Q4	6.7	6.6	3.4	3.3	3.8	3.6	4.1	3.8	-2	-3
1986	Q2	6.6	6.0	2.6	2.4	3.9	3.9	4.3	4.1	.0	.0
	Q4	6.9	6.7	2.8	2.7	4.4	4.2	4.5	4.4	-1	-1
Four-quarter changes: <3>											
1983	Q4 <1>	10.4	10.4	6.3	6.3	3.7	3.7	4.4	4.4	-2.1	-2.1
1984	Q4 <1>	9.3	9.7	5.6	5.9	4.0	4.0	4.4	4.4	-1.3	-1.3
1985	Q4	7.2	6.8	3.6	3.3	3.8	3.4	4.2	3.9	-5	-4
1986	Q4	6.7	6.4	2.7	2.9	4.2	4.0	4.4	4.3	-1	-1

<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.)

	1983				1984			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3173.8	3267.0	3346.6	3431.7	3553.3	3644.7	3694.6	3764.2
Final sales	3216.8	3286.4	3350.9	3419.0	3479.5	3594.1	3622.8	3728.9
Private	2538.0	2604.2	2661.1	2727.6	2775.1	2850.4	2861.8	2947.2
Domestic final purchases	2518.4	2610.7	2677.5	2757.4	2826.6	2909.1	2952.4	2996.4
Personal consumption expenditures	2070.4	2141.6	2181.4	2230.2	2276.5	2332.7	2361.4	2397.4
Goods	1034.6	1073.0	1095.8	1122.8	1152.2	1179.0	1178.6	1191.3
Services	1035.8	1068.6	1085.7	1107.5	1124.4	1153.7	1182.8	1206.1
Gross private domestic investment	405.0	449.6	491.9	540.0	623.8	627.0	662.8	634.3
Residential structures	113.3	129.8	142.3	143.4	151.2	155.6	155.3	153.1
Business fixed investment	334.6	339.3	353.9	383.9	398.8	420.8	435.7	445.9
Change in business inventories	-42.9	-19.4	-4.3	12.7	73.8	50.6	71.8	35.3
Nonfarm	-32.6	-5.4	11.6	14.1	60.6	47.0	63.7	25.9
Net exports of goods and services <1>	19.6	-6.5	-16.4	-29.8	-51.5	-58.7	-90.6	-49.2
Exports	328.5	328.1	342.0	346.1	358.9	362.4	368.6	369.4
Imports	308.9	334.5	358.4	375.9	410.4	421.1	459.3	418.5
Gov't. purchases of goods and services	678.8	682.2	689.8	691.4	704.4	743.7	761.0	781.7
Federal <2>	273.0	270.5	269.2	266.3	267.6	296.4	302.0	316.3
State and local	405.8	411.6	420.6	425.1	436.8	447.4	458.9	465.4
Gross national product in constant (1972) dollars	1491.0	1524.8	1550.2	1572.7	1610.9	1638.8	1645.2	1664.8
Personal income	2662.8	2714.4	2763.3	2836.5	2920.5	2984.6	3047.3	3098.9
Wage and salary disbursements	1608.1	1642.1	1671.3	1715.4	1755.7	1793.1	1819.5	1847.3
Disposable personal income	2261.4	2302.9	2367.4	2428.6	2502.2	2554.3	2606.4	2647.8
Saving rate (percent)	5.7	4.2	5.0	5.3	6.1	5.7	6.3	6.3
Corporate profits with I.V.A. and C.C. Adj.	179.1	216.7	245.0	260.0	277.4	291.1	282.8	297.3
Corporate profits before tax	161.7	198.2	227.4	225.5	243.3	246.0	224.8	235.8
Federal government surplus or deficit (-) (N.I.A. basis)	-185.7	-167.3	-180.9	-180.5	-161.3	-163.7	-180.6	-195.3
High employment surplus or deficit (-) <3>	-80.9	-74.2	-102.5	-113.1	-113.3	-129.6	-146.1	-168.2
State and local government surplus or deficit (-) (N.I.A. basis)	34.1	43.9	47.4	51.2	53.9	54.3	47.6	55.2
Excluding social insurance funds	-1.9	7.0	9.5	12.0	13.4	12.6	4.3	10.7
Civilian labor force (millions)	110.7	111.2	112.1	112.1	112.7	113.5	113.8	114.2
Unemployment rate (percent)	10.4	10.1	9.3	8.5	7.9	7.5	7.4	7.2
Nonfarm payroll employment	88.8	89.6	90.4	91.7	92.8	93.8	94.6	95.4
Manufacturing	18.1	18.3	18.6	19.0	19.4	19.6	19.7	19.7
Industrial production (1967=100)	138.5	144.5	151.8	155.5	159.8	163.1	165.6	164.7
Capacity utilization: all manufacturing (percent)	70.7	73.9	77.4	78.9	80.7	81.8	82.5	81.6
Materials (percent)	70.1	73.5	77.5	79.6	81.6	82.8	82.9	80.8
Housing starts, private (million units, A.R.)	1.64	1.69	1.70	1.70	1.95	1.86	1.66	1.59
New auto sales (millions, A.R.)	8.46	9.10	9.22	9.94	10.52	10.60	10.30	10.29
Domestic models	6.06	6.81	6.98	7.29	8.23	8.23	7.94	7.50
Foreign models	2.40	2.29	2.24	2.65	2.30	2.38	2.36	2.79

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

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

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

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

March 20, 1985

	1983				1984			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	3.3	9.4	6.8	5.9	10.1	7.1	1.6	4.9
Final sales	1.1	6.4	4.9	4.2	3.6	10.3	-1.0	8.5
Private	3.5	8.6	6.2	6.3	4.2	8.5	-2.4	9.1
Domestic final purchases	4.0	12.1	6.9	9.7	7.6	9.5	2.3	3.6
Personal consumption expenditures	2.6	10.0	3.8	6.8	4.6	7.9	.7	3.6
Goods	3.5	12.6	5.4	9.5	7.8	10.7	-1.9	3.5
Services	1.5	7.3	2.1	3.8	1.2	4.6	3.8	3.8
Gross private domestic investment	34.0	52.5	38.4	37.0	71.6	-2.2	24.9	-14.3
Residential structures	64.4	78.5	31.6	4.0	21.3	1.2	-4.6	-5.3
Business fixed investment	.2	9.5	18.7	30.6	20.6	21.3	13.7	6.3
Gov't. purchases of goods and services	-8.1	-2.6	-.5	-4.3	1.0	18.6	5.4	6.3
Federal	-17.3	-5.9	-5.3	-8.7	-2.8	45.2	6.2	15.3
National defense	7.0	7.4	-1.9	9.3	3.8	12.0	-2.2	15.7
State and local	-1.1	-.2	2.7	-1.4	3.5	3.7	4.8	.4
Disposable personal income	2.1	3.4	7.7	8.2	8.6	6.3	3.9	3.8
<u>Current Dollars</u>								
Gross national product	8.5	12.3	10.1	10.6	14.9	10.7	5.6	7.8
Final sales	5.9	8.9	8.1	8.4	7.3	13.8	3.2	12.2
Private	8.0	10.9	9.0	10.4	7.2	11.3	1.6	12.5
Domestic final purchases	5.7	15.5	10.6	12.5	10.4	12.2	6.1	6.1
Personal consumption expenditures	4.8	14.5	7.6	9.2	8.6	10.2	5.0	6.2
Goods	3.6	15.7	8.8	10.2	10.9	9.6	-.1	4.4
Services	6.1	13.3	6.6	8.3	6.2	10.9	10.5	8.1
Gross private domestic investment	34.3	52.0	43.2	45.3	78.0	2.0	24.9	-16.1
Residential structures	79.3	71.9	44.4	3.3	23.6	12.1	-.6	-5.7
Business fixed investment	-5.5	5.7	18.5	38.4	16.5	23.9	14.9	9.8
Gov't. purchases of goods and services	-1.3	2.0	4.5	.9	7.8	24.3	9.6	11.3
Federal	-8.9	-3.6	-2.0	-4.3	2.0	50.5	7.8	20.3
National defense	8.0	9.8	3.3	13.1	12.5	14.7	-.8	21.4
State and local	4.2	5.8	9.0	4.4	11.5	10.0	10.7	5.7
Disposable personal income	4.3	7.5	11.7	10.7	12.7	8.6	8.4	6.5
Personal income	3.6	8.0	7.4	11.0	12.4	9.1	8.7	6.9
Wage and salary disbursements	5.6	8.7	7.3	11.0	9.7	8.8	6.0	6.3
Corporate profits with I.V.A. and C.C.Adj.	93.9	114.4	63.4	26.8	29.6	21.5	-11.1	22.0
Corporate profits before tax	15.4	125.8	73.3	-3.1	35.3	5.0	-30.6	21.2
Nonfarm payroll employment	.5	3.4	3.7	5.8	4.8	4.5	3.3	3.8
Manufacturing	-.9	5.0	7.0	9.1	7.5	4.5	2.1	1.1
Nonfarm business sector								
Output per hour	4.4	8.1	2.1	1.0	2.9	5.5	-1.1	2.9
Compensation per hour	5.7	3.5	2.2	4.1	6.1	3.7	3.6	3.7
Unit labor costs	1.3	-4.2	.1	3.0	3.1	-1.7	4.7	.8
GNP implicit deflator <1>	5.0	2.6	3.1	4.4	4.4	3.3	3.9	2.8
Gross domestic business product								
fixed-weighted price index <2>	2.7	3.9	4.5	3.5	4.2	4.1	4.0	3.2
Excluding food and energy	4.9	3.5	5.4	3.8	3.4	5.4	4.9	3.8
Consumer price index (all urban)	.4	4.3	4.2	4.2	5.2	3.7	3.7	3.6
Industrial production	10.1	18.4	21.8	10.2	11.5	8.6	6.3	-2.2

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

<2> Uses expenditures in 1972 as weights.

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CLASS II FOMC

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

	Projected							
	1985				1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3832.4	3892.3	3953.8	4018.6	4079.2	4138.4	4205.1	4275.3
Final sales	3793.0	3855.3	3918.0	3981.8	4044.9	4105.6	4172.8	4243.0
Private	2995.4	3043.8	3092.5	3142.0	3192.0	3241.3	3296.6	3353.1
Domestic final purchases	3059.7	3118.0	3173.8	3228.1	3280.1	3331.5	3388.2	3443.9
Personal consumption expenditures	2448.0	2489.9	2530.6	2572.7	2613.8	2655.9	2699.3	2741.9
Goods	1213.9	1230.7	1247.1	1264.1	1280.5	1297.2	1314.3	1330.3
Services	1234.1	1259.2	1283.5	1308.6	1333.3	1358.7	1385.0	1411.6
Gross private domestic investment	651.1	665.1	679.0	692.3	700.5	708.4	721.2	734.3
Residential structures	155.4	161.2	166.8	169.7	171.2	171.8	176.3	180.8
Business fixed investment	456.3	466.9	476.4	485.8	495.0	503.8	512.6	521.2
Change in business inventories	39.4	37.0	35.8	36.8	34.3	32.8	32.3	32.3
Nonfarm	32.4	32.0	33.8	36.3	34.3	32.8	32.3	32.3
Net exports of goods and services <1>	-64.3	-74.1	-81.2	-86.1	-88.1	-90.2	-91.6	-90.8
Exports	366.3	366.9	368.8	372.9	378.9	385.4	394.5	404.3
Imports	430.6	441.0	450.0	459.0	467.0	475.6	486.1	495.1
Gov't. purchases of goods and services	797.6	811.5	825.5	839.8	852.9	864.2	876.3	890.0
Federal <2>	325.3	330.3	336.1	342.1	347.5	351.0	355.2	360.8
State and local	472.3	481.1	489.4	497.7	505.4	513.2	521.1	529.2
Gross national product in constant (1972) dollars	1677.6	1691.9	1705.6	1719.6	1729.7	1739.8	1752.0	1763.4
Personal income	3150.2	3204.8	3260.3	3320.6	3374.1	3428.9	3485.1	3542.2
Wage and salary disbursements	1880.9	1913.9	1945.5	1977.7	2010.5	2041.3	2071.9	2103.6
Disposable personal income	2692.7	2737.9	2782.4	2831.0	2882.9	2928.4	2975.5	3022.3
Saving rate (percent)	5.9	5.8	5.7	5.8	6.0	5.9	5.9	5.8
Corporate profits with I.V.A. and C.C. Adj.	305.3	303.9	304.7	302.3	296.4	295.4	298.8	303.8
Corporate profits before tax	239.0	234.1	232.9	227.0	217.1	213.9	214.0	217.5
Federal government surplus or deficit (-) (N.I.A. basis)	-193.2	-195.3	-193.6	-190.6	-188.3	-190.0	-191.4	-191.7
High employment surplus or deficit (-) <3>	-167.5	-173.1	-174.4	-174.3	-171.4	-172.5	-174.9	-175.4
State and local government surplus or deficit(-) (N.I.A. basis)	58.7	58.9	57.0	53.8	52.1	52.0	52.6	53.3
Excluding social insurance funds	13.4	12.8	10.1	6.1	3.6	2.7	2.5	2.4
Civilian labor force (millions)	115.1	115.4	115.8	116.3	116.8	117.3	117.7	118.1
Unemployment rate (percent)	7.3	7.1	6.9	6.8	6.8	6.8	6.7	6.7
Nonfarm payroll employment	96.2	96.7	97.4	98.0	98.5	98.9	99.4	99.8
Manufacturing	19.8	19.9	20.0	20.1	20.2	20.2	20.3	20.4
Industrial production (1967=100)	165.1	166.4	167.9	169.5	170.8	172.0	173.3	174.7
Capacity utilization all manufacturing (percent)	81.2	81.0	81.0	81.0	81.0	81.0	81.0	81.0
Materials (percent)	80.3	80.3	80.4	80.4	80.5	80.4	80.5	80.5
Housing starts, private (million units, A.R.)	1.71	1.80	1.75	1.75	1.75	1.75	1.80	1.80
New auto sales (millions, A.R.)	10.98	10.85	11.00	11.05	10.95	10.90	10.80	10.70
Domestic models	8.53	8.30	8.25	8.20	8.15	8.08	7.90	7.70
Foreign models	2.45	2.55	2.75	2.85	2.80	2.90	2.90	3.00

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

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

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

CONFIDENTIAL - FR
CLASS II FOMC

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

	Projected							
	1985				1986			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	3.1	3.5	3.3	3.3	2.4	2.4	2.8	2.6
Final sales	2.5	3.8	3.5	3.4	2.7	2.6	2.9	2.7
Private	2.7	4.0	3.6	3.4	2.9	2.8	3.2	2.9
Domestic final purchases	6.2	4.9	4.3	3.7	3.0	2.7	3.0	2.6
Personal consumption expenditures	6.2	4.1	3.5	3.2	2.8	2.7	2.5	2.1
Goods	7.0	4.6	3.8	3.4	2.9	2.7	2.5	2.0
Services	5.3	3.5	3.2	3.0	2.6	2.6	2.5	2.3
Gross private domestic investment	9.4	5.9	5.9	5.2	2.0	1.7	3.9	3.9
Residential structures	3.0	12.0	11.1	3.6	.0	-2.3	6.6	6.4
Business fixed investment	6.9	7.5	6.5	6.0	5.3	4.6	4.2	3.9
Gov't. purchases of goods and services	1.9	3.2	3.0	3.3	2.1	1.7	1.7	1.8
Federal	2.6	3.5	3.8	4.6	2.2	1.4	1.5	1.5
National defense	6.8	7.1	5.6	4.2	1.8	1.1	2.4	4.1
State and local	1.4	2.9	2.4	2.4	2.0	1.9	1.9	1.9
Disposable personal income	4.5	3.9	3.5	3.5	3.7	2.5	2.4	2.1
<u>Current Dollars</u>								
Gross national product	7.4	6.4	6.5	6.7	6.2	5.9	6.6	6.8
Final sales	7.1	6.7	6.7	6.7	6.5	6.1	6.7	6.9
Private	6.7	6.6	6.6	6.6	6.5	6.3	7.0	7.0
Domestic final purchases	8.7	7.8	7.4	7.0	6.6	6.4	7.0	6.7
Personal consumption expenditures	8.7	7.0	6.7	6.8	6.6	6.6	6.7	6.5
Goods	7.8	5.6	5.4	5.6	5.3	5.3	5.4	5.0
Services	9.6	8.4	7.9	8.1	7.8	7.8	8.0	7.9
Gross private domestic investment	11.0	8.9	8.6	8.1	4.9	4.6	7.4	7.4
Residential structures	6.1	15.8	14.6	7.1	3.6	1.4	10.9	10.6
Business fixed investment	9.7	9.6	8.4	8.1	7.9	7.3	7.2	6.8
Gov't. purchases of goods and services	8.4	7.1	7.1	7.1	6.4	5.4	5.7	6.4
Federal	11.8	6.3	7.2	7.4	6.4	4.2	4.8	6.4
National defense	14.7	10.1	9.4	7.5	6.3	4.8	6.4	8.2
State and local	6.1	7.7	7.1	6.9	6.4	6.3	6.3	6.4
Disposable personal income	7.0	6.9	6.7	7.2	7.5	6.5	6.6	6.4
Personal income	6.8	7.1	7.1	7.6	6.6	6.7	6.7	6.7
Wage and salary disbursements	7.5	7.2	6.8	6.8	6.8	6.3	6.1	6.3
Corporate profits with I.V.A. and C.C.Adj.	11.3	-1.8	1.0	-3.1	-7.6	-1.4	4.8	6.9
Corporate profits before tax	5.7	-7.9	-2.1	-9.7	-16.3	-5.8	.3	6.7
Nonfarm payroll employment	3.0	2.5	2.6	2.6	1.9	1.8	2.0	1.7
Manufacturing	.6	2.0	2.0	2.0	1.8	1.8	1.6	1.4
Nonfarm business sector								
Output per hour	1.8	1.1	1.2	1.2	.8	.8	1.2	1.4
Compensation per hour	4.3	4.2	4.3	4.3	4.8	4.4	4.5	4.6
Unit labor costs	2.5	3.1	3.1	3.1	4.0	3.6	3.3	3.2
GDP implicit deflator <1>	4.2	2.8	3.1	3.3	3.7	3.5	3.7	4.1
Gross domestic business product								
fixed-weighted price index <2>								
Excluding food and energy	3.1	3.5	3.5	3.7	3.9	3.9	4.1	4.3
Consumer price index (all urban)	3.7	4.3	3.8	3.8	4.1	4.1	4.4	4.4
Consumer price index (all urban)	3.1	3.3	3.5	3.8	4.0	4.0	4.2	4.4
Industrial production	1.0	3.2	3.7	3.7	3.1	2.9	3.2	3.3

<1> Excluding Federal pay increase, the rate of change in 1985-Q1 is 3.8 percent and in 1986-Q1 is 3.6 percent.

<2> Uses expenditures in 1972 as weights.

March 20, 1985

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

	1979	1980	1981	1982	1983	1984	—Projected—	
							1985	1986
Gross national product	2417.8	2631.7	2957.7	3069.2	3304.8	3664.2	3924.3	4174.5
Final sales	2403.5	2641.4	2931.7	3095.4	3318.3	3606.3	3887.0	4141.6
Private	1929.2	2103.7	2335.2	2444.9	2632.7	2858.6	3068.5	3270.7
Domestic final purchases	1915.9	2079.7	2307.2	2425.9	2641.0	2921.1	3144.9	3360.9
Personal consumption expenditures	1507.1	1668.0	1849.1	1984.9	2155.9	2342.0	2510.3	2677.7
Goods	813.4	883.5	966.1	1002.6	1081.5	1175.3	1238.9	1305.6
Services	693.7	784.5	883.0	982.2	1074.4	1166.7	1271.4	1372.2
Gross private domestic investment	423.0	401.9	484.2	414.9	471.6	637.0	671.9	716.1
Residential construction	118.5	102.9	104.3	91.3	132.2	153.8	163.3	175.0
Business fixed investment	290.2	308.8	353.9	349.6	352.9	425.3	471.3	508.1
Change in business inventories	14.3	-9.8	26.0	-26.1	-13.5	57.9	37.3	32.9
Nonfarm	8.6	-4.5	18.2	-23.9	-3.1	49.3	33.6	32.9
Net exports of goods and services <1>	13.2	23.9	28.0	19.0	-8.3	-62.5	-76.4	-90.2
Exports	281.3	338.8	369.9	348.4	336.2	364.8	368.7	390.8
Imports	268.1	314.8	341.9	329.4	344.4	427.3	445.1	481.0
Gov't. purchases of goods and services	474.4	537.8	596.5	650.5	685.5	747.7	818.6	870.8
Federal <2>	168.3	197.0	228.9	258.9	269.7	295.6	333.4	353.6
State and local	306.0	340.8	367.6	391.5	415.8	452.1	485.1	517.2
Gross national product in constant (1972) dollars	1479.4	1475.0	1512.1	1480.0	1534.7	1639.9	1698.7	1746.2
Personal income	1951.1	2165.3	2429.4	2584.6	2744.3	3012.8	3233.9	3457.6
Wage and salary disbursements	1237.6	1356.7	1493.1	1568.7	1659.2	1803.9	1929.5	2056.8
Disposable personal income	1650.2	1828.9	2041.7	2180.5	2340.1	2577.7	2761.0	2952.3
Saving rate (percent)	5.9	6.0	6.7	6.2	5.0	6.1	5.8	5.9
Corporate profits with I.V.A. and C.C.Adj.	194.8	175.4	190.0	159.2	225.2	287.1	304.0	298.6
Corporate profits before tax	252.7	234.6	221.3	165.6	203.2	237.5	233.2	215.6
Federal government surplus or deficit (-) (N.I.A. basis)	-16.1	-61.3	-64.2	-148.2	-178.6	-175.2	-193.1	-190.4
High employment surplus or deficit (-)	-20.8	-36.4	-31.3	-61.6	-92.7	-139.3	-172.3	-173.5
State and local government surplus or deficit (-) (N.I.A. basis)	30.6	30.6	37.6	32.9	44.1	52.8	57.1	52.5
Excluding social insurance funds	6.8	3.5	7.8	-8	6.6	10.3	10.6	2.8
Civilian labor force (millions)	105.0	106.9	108.7	110.2	111.6	113.5	115.6	117.5
Unemployment rate (percent)	5.8	7.1	7.6	9.7	9.6	7.5	7.0	6.7
Nonfarm payroll employment (millions)	89.8	90.4	91.2	89.6	90.1	94.2	97.1	99.1
Manufacturing	21.0	20.3	20.2	18.8	18.5	19.6	19.9	20.3
Industrial production (1967=100)	152.5	147.0	150.9	138.6	147.6	163.3	167.2	172.7
Capacity utilization: all manufacturing (percent)	86.0	79.6	79.4	71.1	75.2	81.7	81.1	81.0
Materials (percent)	87.6	80.4	80.7	70.1	75.2	82.0	80.4	80.5
Housing starts, private (million units, A.R.)	1.72	1.30	1.10	1.06	1.70	1.76	1.75	1.77
New auto sales (millions, A.R.)	10.68	9.04	8.56	8.00	9.18	10.39	10.97	10.84
Domestic models	8.36	6.62	6.24	5.77	6.77	7.95	8.32	7.94
Foreign models	2.32	2.42	2.32	2.23	2.41	2.44	2.65	2.90

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

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

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

	1979	1980	1981	1982	1983	1984	Projected	
							1985	1986
<u>Constant (1972) Dollars</u>								
Gross national product	2.8	-.3	2.5	-2.1	3.7	6.9	3.6	2.8
Final sales	3.5	.5	1.5	-.7	3.2	5.0	4.1	3.0
Private	4.0	.1	1.6	-1.3	4.1	5.3	4.0	3.2
Domestic final purchases	2.9	-1.0	2.2	-.2	5.6	7.6	4.8	3.3
Personal consumption expenditures	2.7	.5	2.0	1.3	4.8	5.3	4.2	2.9
Goods	1.9	-1.4	1.7	.4	6.0	7.1	4.3	3.1
Services	3.7	2.7	2.3	2.5	3.4	3.3	4.0	2.7
Gross private domestic investment	-.2	-11.8	10.7	-15.9	13.7	31.0	4.2	3.6
Residential structures	-5.3	-20.3	-5.5	-14.8	41.7	12.2	3.0	3.5
Business fixed investment	7.3	-2.4	5.5	-4.6	2.5	19.6	8.4	5.3
Gov't. purchases of goods and services	1.3	2.2	.9	2.0	-.3	3.5	4.6	2.4
Federal	1.8	4.2	3.7	6.1	-.6	5.4	8.0	2.6
National defense	2.6	3.9	5.0	7.6	7.1	5.7	7.3	3.1
State and local	1.1	1.0	-.6	-.6	.0	2.2	2.2	2.2
Disposable personal income	2.7	.6	2.7	.9	3.5	6.7	4.1	3.2
<u>Current Dollars</u>								
Gross national product	11.7	8.8	12.4	3.8	7.7	10.9	7.1	6.4
Final sales	12.4	9.9	11.0	5.6	7.2	8.7	7.8	6.5
Private	13.1	9.0	11.0	4.7	7.7	8.6	7.3	6.6
Domestic final purchases	12.3	8.5	10.9	5.1	8.9	10.6	7.7	6.9
Personal consumption expenditures	11.9	10.7	10.9	7.3	8.6	8.6	7.2	6.7
Goods	11.7	8.6	9.3	3.8	7.9	8.7	5.4	5.4
Services	12.2	13.1	12.6	11.2	9.4	8.6	9.0	7.9
Gross private domestic investment	9.4	-5.0	20.5	-14.3	13.7	35.1	5.5	6.6
Residential structures	6.6	-13.2	1.3	-12.4	44.7	16.3	6.2	7.2
Business fixed investment	16.6	6.4	14.6	-1.2	.9	20.5	10.8	7.8
Gov't. purchases of goods and services	9.8	13.4	10.9	9.0	5.4	9.1	9.5	6.4
Federal	9.6	17.1	16.2	13.1	4.2	9.6	12.8	6.1
National defense	11.5	17.3	17.2	16.8	11.7	10.4	11.8	7.0
State and local	9.9	11.4	7.9	6.5	6.2	8.7	7.3	6.6
Disposable personal income	12.0	10.8	11.6	6.8	7.3	10.2	7.1	6.9
Personal income	12.6	11.0	12.2	6.4	6.2	9.8	7.3	6.9
Wage and salary disbursements	11.9	9.6	10.1	5.1	5.8	8.7	7.0	6.6
Corporate profits with I.V.A. and C.C.Adj.	1.2	-9.9	8.3	-16.2	41.5	27.5	5.9	-1.8
Corporate profits before tax	10.3	-7.1	-5.7	-25.2	22.8	16.9	-1.8	-7.6
Nonfarm payroll employment	3.6	.6	.8	-1.7	.6	4.5	3.1	2.1
Manufacturing	2.6	-3.6	-.6	-6.9	-1.5	5.9	1.7	1.8
Nonfarm business sector								
Output per hour	-1.5	-.7	1.5	.2	3.5	2.7	1.6	1.0
Compensation per hour	9.0	10.3	9.6	8.8	4.9	4.1	4.0	4.5
Unit labor costs	10.7	11.1	8.0	7.7	1.4	1.4	2.4	3.4
GNP implicit deflator	8.6	9.2	9.6	6.0	3.8	3.7	3.4	3.5
Gross domestic business product								
fixed-weighted price index <1>	9.9	10.0	9.6	6.8	3.8	4.0	3.5	3.8
Excluding food and energy	8.8	8.5	9.4	7.0	4.6	4.3	4.1	4.1
Consumer price index (all urban)	11.3	13.5	10.3	6.1	3.2	4.3	3.4	3.9
Industrial production	4.4	-3.6	2.6	-8.1	6.4	10.7	2.4	3.3

<1> Uses expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS
(Billions of dollars)

Fiscal Year	FY1985 ^{a/2/}		FY1986 ^{a/2/}		CY 1984 ^a	FY1985 ^b	FRB staff estimates									
	Admin. 1/	FRB Staff	Admin. 1/	FRB Staff			Calendar quarters; not seasonally adjusted									
	1984	1985	1984	1985			1984	1985				1986				
							IV ^a	I	II	III	IV	I	II	III		
Unified budget receipts	646	737	735	794	789	683	744	166	177	206	186	175	184	230	199	
Unified budget outlays	842	947	941	972	975	867	950	239	234	233	236	247	241	243	243	
Surplus/deficit(-), unified budget	-175	-210	-206	-178	-186	-184	-206	-73	-57	-27	-50	-72	-57	-13	-44	
Surplus/deficit(-), off-budget agencies ³	-10	-12	-12	-2	-5	-10	-14	1	-4	-5	-5	-1	-1	-2	-1	
Combined deficit to be financed	-185	-222	-218	-180	-191	-195	-220	-72	-61	-32	-55	-73	-58	-15	-45	
Means of financing combined deficit:																
Net borrowing from public	171	210	200	181	186	199	199	64	40	45	51	64	58	15	50	
Decrease in cash operating balance	7	10	10	0	0	-5	8	13	8	-8	-3	10	-5	0	-5	
Other ⁴	8	1	8	-1	5	2	13	-6	12	-4	6	0	5	0	0	
Cash operating balance, end of period	30	20	20	20	20	17	10	18	10	18	20	10	15	15	20	
Item: Sponsored agency borrowing ⁵	30	42	14	46	20	32	16	3	2	4	5	5	5	5	5	
HIA Budget								Seasonally adjusted annual rates								
Receipts	688	758	751	827	810	705	768	722	748	760	775	790	804	816	829	
Expenditures	860	948	945	992	1000	880	961	917	941	955	968	980	993	1006	1020	
Purchases	283	327	327	355	349	296	333	316	325	330	336	342	347	351	355	
Defense	215	242	242	272	261	221	248	231	239	245	251	255	259	262	266	
Nondefense	68	85	85	83	88	74	86	85	86	85	85	87	88	89	89	
All other expenditures	577	621	618	637	651	584	628	601	616	625	632	638	646	655	665	
Surplus/deficit(-)	-172	-190	-194	-166	-190	-175	-193	-195	-193	-195	-194	-191	-188	-190	-191	
High employment surplus/deficit(-) evaluated at 6 percent unemployment	-126	n.a.	-171	n.a.	-173	-139	-172	-168	-168	-173	-174	-174	-171	-173	-175	

^a—actual

^b—estimated

n.a.—not available

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

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

3. Includes Federal Financing Bank, Postal Service Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank and Strategic Petroleum Reserve.
 4. Checks issued less checks paid, accrued items and other transactions.
 5. Sponsored agency borrowing includes net debt issuance by Federal Home Loan Banks, FHLMC (excluding participation certificates), FNMA (excluding mortgage-backed securities), Federal Land Banks, Federal Intermediate Credit Banks, Banks for Cooperatives, and Student Loan Marketing Association marketable debt on a payment basis. The Administration's definition of borrowing by these agencies is somewhat broader.

DOMESTIC FINANCIAL DEVELOPMENTS

Recent developments. Although the federal funds rate is up only a little from the level prevailing prior to the last FOMC meeting, other short-term rates have risen 30 to 75 basis points. Published data showing strong M1 growth, together with signs of tauter reserve positions, heightened concerns about a tightening of monetary policy. The collapse of E.S.M. Government Securities and resultant problems of Ohio savings and loans briefly induced a widening of spreads between short-term Treasury and private yields. Long-term market interest rates have increased as much as most short-term rates, owing partly to the lack of progress toward federal deficit reduction. New commitment rates for conventional home mortgages also have moved up since the last FOMC meeting.

Growth of M1 in February surged to a 14 percent annual rate, putting the level of this aggregate close to the top of the parallel band associated with its 1985 target range. Overall transactions balances may still have been boosted by previous declines in market interest rates, but M1 appears to have been little affected by the January 1 cut in the minimum balance on MMDAs and Super NOWs to \$1,000. The broader monetary aggregates, by contrast, grew more slowly last month. Rates on MMDAs and money market mutual fund shares became relatively less attractive as market interest rates rose, and inflows into these components of M2 slackened. Institution-only money funds, included in M3, posted a sizable outflow, and thrift large time deposits leveled off. However, reliance of commercial banks on large CDs increased as their credit growth was more than double the January pace. M2 and M3 stayed above the upper ends

of their target cones in February, but remained within their associated parallel bands.

Credit flows to nonfinancial sectors in the aggregate appear to have moderated substantially so far in 1985 from the record fourth-quarter pace. Borrowing by nonfinancial corporations apparently was lighter in January-February, despite continued net retirements of equity and a likely widening of the gap between capital expenditures, including inventories, and internally generated funds. Although business loans at commercial banks and nonfinancial commercial paper both spurted in February, taken together their average growth over the two months was off appreciably from that registered in the final three months of last year. Bond financing also has moderated since the fourth quarter.

Federal government borrowing in the current quarter, though still sizable, also has slackened, in part owing to slower-than-normal disbursement of tax refunds and a rundown in the Treasury's cash balance. Note and bond issuance continues to account for the bulk of new funds raised. Sponsored agency financing has been subdued, with paydowns of debt expected this quarter at Farm Credit Banks and only a small amount of borrowing at Federal Home Loan Banks, despite a pickup in advances to member thrift institutions. Overall borrowing by state and local governments apparently has increased somewhat in early 1985. Tax-exempt bond issuance has diminished considerably since the year-end surge, which included many revenue bonds for corporate financing; the net liquidation of short-term tax-exempt securities has slowed substantially as well, reflecting the reduced run-off of HUD project notes.

Consumer credit growth apparently has remained substantial, associated with continued strength in sales of autos and other consumer goods, as well as a further downward drift in consumer finance rates, at least through early February. Despite the mounting ratio of installment debt outstanding to disposable income, the repayment burden evidently remained manageable through year-end, judging by available data on delinquencies on such debt.

Residential mortgage credit flows seem to have changed little, on balance, so far this year. FSLIC-insured savings institutions reported net mortgage lending in January below the fourth-quarter pace, as well as runoffs of mortgage-backed security holdings. Their new and outstanding commitments also fell. GNMA originations have been stronger, however, and growth in real estate loans held by commercial banks has been well maintained on average over January and February. At all major lenders through early February, home mortgage credit demands continued to shift toward fixed-rate and away from adjustable-rate conventional loans, while the average closing-rate spread on these types of loans widened further.

Outlook. Overall borrowing by nonfinancial sectors in the second quarter is expected to remain close to the reduced pace projected for the first quarter, with a slowing of private borrowing about offsetting a strengthening of Treasury debt issuance. The federal budget deficit is expected to decline somewhat less than usual at the time of spring tax payments, and federal borrowing, seasonally adjusted, is anticipated to increase along with a catch-up of refund disbursements and a replenishment of the Treasury cash balance.

State and local borrowing is likely to move lower, as--with bond rates remaining above recent lows--the pace of new general obligation and refunding issues tapers off. The financing gap of nonfinancial corporations in the coming quarter is likely to edge up a little, as capital spending rises a bit and internal funds stay about flat, but business borrowing is expected to drop off in the second quarter if the Phillips debt-equity swap is completed before the end of March.

In the household sector, consumer installment borrowing is projected to come off some in the second quarter, along with moderating purchases of consumer durables and growing repayments on indebtedness incurred earlier. Home mortgage flows seem likely to rise only slightly; the new constraints on asset expansion at thrift institutions, coupled with more cautious underwriting standards on the part of loan originators and insurers, should tend to temper credit expansion relative to expenditures on residential construction.

On balance, short-term market interest rates are anticipated to remain around recent levels over the near future, but long-term rates could edge off with diminished concerns about a monetary policy tightening. However, credit markets may remain skittish, and spreads between private and Treasury yields are likely to be especially sensitive not only to the resolution of the E.M.S. Government Securities and Ohio thrift situations but also to any new information bearing on credit quality.

INTERNATIONAL DEVELOPMENTS

Recent developments. The trade-weighted average exchange value of the dollar has declined, net, by about 3/4 percent since the last FOMC meeting. Early in the period the dollar was very strong, rising some 5 percent to a record high, bolstered by upward revisions in U.S. real GNP statistics for the fourth quarter of 1984 and by market perceptions that the Federal Reserve may have begun tightening bank reserve provisions.

. Most recently the dollar has weakened sharply, in the wake of low February industrial production figures for the United States and, particularly, after the closing of privately-insured Ohio thrift institutions.

. U.S. authorities sold a total of \$322.5 million, of which \$306 million was against marks and \$16.5 million was against sterling.

The U.S. merchandise trade deficit increased in January from the low December rate. Exports remained at the strong December rate, but imports rose sharply after several relatively low months. The January deficit, at a \$120 billion annual rate (s.a.), was considerably higher

than the rate for the fourth quarter as a whole, but was still lower than the extraordinarily large third-quarter rate.

Net capital inflows through U.S. banking offices amounted to \$13-1/2 billion in January, a sharp turnaround from net outflows for December and the fourth quarter as a whole. Foreign net purchases of U.S. corporate bonds remained strong in January, while purchases of Treasury securities dropped sharply; there were small net sales by foreigners of U.S. corporate stocks. Foreign official reserve assets in the United States declined sharply in January and, , presumably dropped further in February.

For 1984 as a whole, there were large private inflows through banks and through net foreign purchases of U.S. Treasury securities and U.S. corporate bonds. The apparent increase in net foreign purchases of corporate bonds reported in U.S. balance of payments accounts is exaggerated when compared to recent years, however, due to a reclassification in reporting certain Euro-bond issues.

Economic recovery abroad continued at an uneven pace. Real GNP growth slowed in the fourth quarter in Germany, France, and Canada while it rose in the United Kingdom and, especially, in Japan. Japan recorded its highest fourth quarter growth rate since 1972 (6.3 percent, s.a.a.r.). Available industrial production data for the first quarter show a very unclear picture: severe winter weather in Europe has reportedly had significant impacts on production in several countries.

Inflation rates in early 1985 appear to have generally risen somewhat from late 1984 levels, partly reflecting seasonal effects, but

perhaps also in part reflecting the dollar's sharp rise in the last several months. Unemployment abroad remains at historically high rates in all countries. Recent data indicate continuing record trade and current account surpluses for Japan. Germany's trade and current accounts remain in strong surplus, as do Canada's. Trade deficits appear to be declining in France and the United Kingdom, while rising in Italy.

Several major developing countries are experiencing difficulties in meeting the monetary/fiscal targets of their IMF programs. This, in turn, is hampering the completion of multi-year bank debt reschedulings (Brazil, Argentina, Philippines) or the access to further IMF drawings. Inflation remains high in Mexico, Brazil, and Argentina, though Mexico and Argentina have recently moved to raise interest rates substantially, and Brazil has enacted various measures limiting public expenditures. The Mexican government also recently increased the daily rate of devaluation of the peso. Mexico reported real GNP growth of 3-1/2 percent in 1984, well above earlier estimates.

U.S.-chartered banks reported a \$2 billion decline in gross claims on foreigners for the fourth quarter, bringing the fourth quarter-to-fourth quarter decline to \$30 billion. (Over one-third of the decrease reflected the higher exchange value of the dollar.) Most of the decline for the year was in claims on G-10 countries and represented a sharp cutback in interbank placements. Total claims on non-OPEC developing countries showed little change for the year: claims on Brazil increased by \$3 billion, while claims on nearly all other developing countries declined.

Outlook. The staff continues to project a moderate depreciation of the dollar throughout the period, though on a higher path than in the last Greenbook.

The projection for GNP growth for major foreign industrial countries is little changed at just under 3 percent for 1985 and 1986. For non-OPEC developing countries the projection is for growth of around 4-1/2 percent. Inflation rates on average in major industrial countries abroad are forecast to be slightly above the U.S. rate in 1985 and slightly below in 1986.

The staff forecast for the current account shows a somewhat larger deficit for 1985 (\$114 billion) and little change in the 1986 projection (\$131 billion) as compared to the last Greenbook. The effects of a higher assumed path for the dollar over the entire period are largely offset by those of a lower projection for U.S. economic activity and, especially in 1986, a downward reassessment of U.S. oil consumption and imports.

MARCH 19, 1985

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

	1984	ANNUAL		1984		1985				1986			
		1985-P	1986-P	Q3	Q4	Q1-P	Q2-P	Q3-P	Q4-P	Q1-P	Q2-P	Q3-P	Q4-P
1. GNP EXPORTS AND IMPORTS 1/													
CURRENT \$, NET	-62.5	-76.5	-90.3	-90.6	-49.2	-64.4	-74.2	-81.3	-86.2	-88.2	-90.3	-91.7	-90.9
EXPORTS OF G+S	364.8	368.7	390.8	368.6	369.4	366.3	366.9	368.8	372.9	378.9	385.4	394.5	404.3
IMPORTS OF G+S	427.3	445.1	481.0	459.3	418.5	430.6	441.0	450.0	459.0	467.0	475.6	486.1	495.1
CONSTANT 72 \$, NET	-14.2	-25.9	-29.1	-27.0	-10.2	-21.8	-25.1	-27.7	-28.9	-29.7	-29.7	-29.1	-28.1
EXPORTS OF G+S	146.3	146.2	149.2	147.4	148.2	146.2	146.0	146.0	146.6	147.3	148.1	149.9	151.6
IMPORTS OF G+S	160.5	172.1	178.4	174.4	158.4	168.0	171.1	173.7	175.5	177.0	177.8	179.0	179.7
2. U.S. MERCHANDISE TRADE BALANCE 2/	-107.4	-113.1	-127.9	-131.8	-91.5	-101.3	-110.9	-117.7	-122.6	-124.8	-127.7	-130.2	-128.9
EXPORTS	220.3	224.2	233.8	222.5	225.0	225.4	224.2	223.2	223.9	226.8	230.3	235.2	242.8
AGRICULTURAL	38.4	34.0	36.3	36.3	38.7	35.0	34.0	33.4	33.6	35.0	35.8	36.7	37.8
NONAGRICULTURAL	181.9	190.2	197.4	186.2	186.3	190.4	190.2	189.8	190.3	191.8	194.5	198.5	204.9
IMPORTS	327.8	337.3	361.7	354.2	316.6	326.7	335.1	340.9	346.5	351.6	358.0	365.3	371.7
PETROLEUM AND PRODUCTS	57.3	52.6	50.4	57.8	56.4	46.4	55.4	55.6	53.2	50.1	49.8	50.9	50.8
NONPETROLEUM	270.5	284.7	311.3	296.4	260.2	280.4	279.7	285.3	293.3	301.5	308.2	314.4	321.0
3. U.S. CURRENT ACCOUNT BALANCE	-101.7	-114.4	-131.0	-134.4	-94.7	-99.9	-110.9	-119.4	-127.3	-126.4	-130.0	-132.9	-134.5
OF WHICH: NET INVESTMENT INCOME	18.1	13.7	10.9	11.5	16.2	15.0	13.9	13.2	12.7	11.6	11.2	11.1	9.6
4. FOREIGN OUTLOOK 3/													
REAL GNP--TEN INDUSTRIAL 4/	2.9	3.0	2.9	4.0	3.9	2.5	3.2	3.0	3.0	2.9	2.8	2.7	2.7
REAL GNP--NONOPEC LDC 5/	4.2	4.4	4.6	4.8	4.5	4.3	4.3	4.3	4.3	4.4	4.7	5.1	5.5
CONSUMER PRICES--TEN IND. 4/	4.9	4.2	3.9	2.5	4.8	4.9	3.9	3.7	4.0	3.9	3.9	3.7	3.9

1/ ECONOMIC ACTIVITY AND PRODUCT ACCOUNT DATA.

2/ INTERNATIONAL ACCOUNTS BASIS.

3/ PERCENT CHANGE, ANNUAL RATES.

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

5/ WEIGHTED BY SHARE IN NONOPEC LDC GNP.

P/ PROJECTED