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December 12, 1984

## **SUMMARY AND OUTLOOK**

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Prepared for the Federal Open Market Committee

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

## DOMESTIC NONFINANCIAL DEVELOPMENTS

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Recent developments. Final demands were still sluggish early in the fourth quarter, and firms have responded by adjusting orders and production and reducing inventory investment. The weakness in production and employment has been concentrated in the industrial sector while hiring in trade and services has continued at a brisk pace. Price and wage inflation remain moderate as pressures on domestic resources are limited and the exchange rate remains high.

Industrial production, excluding the effects of strikes on auto output, declined in September and October, holding manufacturers' inventory accumulation in the two months to a \$18-1/2 billion annual rate in book value terms—less than half the pace of the preceding seven months. In November, production rose moderately with the increase primarily due to a rebound in auto assemblies from 7 million to nearly 8 million units per year. With the exception of defense equipment, the recent slack in production has been fairly widespread among nonauto consumer goods, business equipment, and materials.

Factory hiring also has been slow in recent months, but labor demand has been strong in the service-producing sector. Nonfarm payroll employment rose 300,000 in November after a gain of around 350,000 in October. A rise of 90,000 manufacturing jobs over the two months failed to offset entirely the sharp drop that occurred in September; over the same period, however, retailers and service establishments added 450,000 workers to their payrolls. Moreover, the household survey reported a drop in the civilian unemployment rate of 0.2 percentage point to 7.2 percent in November after four months of little change.

Growth in personal income has been well maintained by the gains in employment and by the further rise in interest payments, and consumer confidence still appears to be relatively high. Consumer spending, however, has not kept pace with rising income. Personal consumption outlays edged lower in October after a bounceback a month earlier; spending for both durables and nondurables declined while outlays for services rose only moderately. Moreover, initial reports of sales by major chain stores in November were disappointing. With sales sluggish and inventories quite high going into the autumn, many retailers appear to have adjusted their ordering policies and to have stepped up promotion efforts in an attempt to pare stocks. In the auto sector, sales were unchanged in November from a month earlier: domestic models were still selling at a depressed 7.2 million unit annual rate while sales of imports remained at a strong 2.8 million unit rate.

Business spending evidently has decelerated sharply from its earlier torrid pace. In October, shipments of nondefense capital goods by domestic producers dropped back after a large gain in September, as did imports of capital goods. In addition, outlays for nonresidential construction have slowed. October's sharp decline in new orders for nondefense capital goods suggests some additional near-term weakness in equipment outlays--at least for domestically-produced goods. However, surveys of capital spending plans for 1985 indicate that firms plan to increase outlays 10 to 11 percent in nominal terms.

Although housing starts dipped again in October, home sales appear to have begun to respond to lower mortgage interest rates. Sales of new homes jumped sharply in September and rose a bit further in October to

their highest level since March; sales of existing homes, which had been on a five-month slide, flattened out. Nevertheless, total private housing starts, at 1.5 million units per year in October, were at their lowest level since the beginning of the current business expansion.

Recent data continue to show evidence of moderate inflation trends. In October, the consumer price index rose 0.4 percent for a second month. Prices for consumer services (excluding energy) have been rising 0.5 percent a month so far this year, somewhat above last year's pace. But the combination of pressures from import competition and lower labor costs has reduced the average monthly price increase for consumer goods (excluding food and energy) to 0.3 percent. The producer price index for finished goods fell 0.2 percent in both October and November. Spot prices for industrial commodities generally have been on a downward trend since midyear, and price weakness also is evident in markets for petroleum products and agricultural crops. However, a recent upswing in livestock prices suggests some upward pressures on meat prices in the near term.

For labor costs, the November report on the index of average hourly earnings indicate continued moderate wage increases for production workers. Over the past year, the index has risen around 3 percent, slowing from almost a 4 percent increase in 1983. Wage rates in manufacturing and construction have continued to rise quite slowly this year, and some deceleration has occurred in the service-producing industries. Hourly compensation, which includes benefit costs as well as wages, rose at a 3-3/4 percent annual rate in the third quarter--the same as in the preceding quarter. However, productivity edged down 3/4 percent at an annual rate, after strong cyclical gains earlier in the year.

Outlook. The staff projects that real GNP will show another small rise of around 1-1/4 percent at an annual rate in the final quarter of 1984. This projection assumes that final sales strengthen somewhat by the end of the year, after sagging in the third quarter. Employment and income gains along with a still-high level of consumer confidence are consistent with a moderate rise in consumer spending, and federal government purchases are anticipated to increase appreciably. Business fixed investment, however, is projected to contribute only minimally to growth this quarter for the first time in a year and a half. Final demand is likely to be satisfied to a considerable extent by a slower rate of inventory investment, damping current production. Inflation, as measured by the fixed-weighted price index for gross domestic business product, is projected to be at just under a 4-1/2 percent annual rate, little different than over the first three quarters of the year.

The assumptions underlying the staff projection have changed only a little since the last Greenbook. For monetary policy, growth in M1 and M2 during 1985 is assumed to be at or somewhat above the midpoints of the tentative growth ranges established by the FOMC in July. Interest rates are assumed to remain around recent levels in the near term, but some upward pressure on rates is expected to develop over the course of 1985. For fiscal policy, the staff now projects a deficit of around \$200 billion in fiscal year 1985, which continues to incorporate the \$25 billion in deficit-reduction measures that were enacted by the last Congress but adds \$14 billion for federal financing of public housing notes previously issued by state and local governments. The lower level of economic

activity now projected by the staff also contributes to a larger deficit. The staff's expectation regarding the exchange rate has been revised, with the dollar now projected to depreciate somewhat less this coming year from a current level that is higher than assumed in the last Greenbook.

Real GNP is projected to grow around 3 percent over the four quarters of 1985. The resumption of moderate growth in final sales that is anticipated to begin in the final quarter of 1984 is expected to extend into early next year. Household spending, particularly for autos, is projected to pick up again, as are business outlays for equipment. In addition, homebuilding is expected to respond to lower levels of mortgage interest rates. Defense spending is anticipated to remain a source of strength throughout the year. But a further reduction in inventory accumulation is expected early next year, and thereafter inventory investment will not contribute to growth of real GNP. In addition, export growth is likely to remain weak, and imports are projected to increase somewhat further.

Given the growth path for real GNP in 1985, only a small amount of slack in resource utilization is projected to be taken up next year. The civilian unemployment rate is expected to decline from around 7-1/4 percent in the fourth quarter of 1984 to around 7 percent by the final quarter of 1985. Manufacturing capacity utilization is projected to remain slightly below 82 percent throughout the year.

Thus, no significant upward pressure on wage and price inflation is expected to develop next year in either labor or product markets. In addition, food prices are expected to rise about in line with inflation in general while energy prices are anticipated to increase very slowly

again next year. The moderate decline projected for the foreign exchange value of the dollar is expected to exert some upward pressure on prices, but mostly in the second half of the year. On balance, the fixed-weighted index for gross domestic business product is projected to increase around 4 percent during 1985, about the same pace as in 1984.

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



## STAFF GNP PROJECTIONS

Percent changes, annual rate

	Nominal GNP		Real GNP		Gross domestic business product fixed-weighted price index				Unemployment rate (percent)			
					Total		Excluding food and energy					
	10/31/84	12/12/84	10/31/84	12/12/84	10/31/84	12/12/84	10/31/84	12/12/84	10/31/84	12/12/84		
<b>Annual changes:</b>												
1982	<1>	3.8	3.8	-2.1	-2.1	6.0	6.0	7.0	7.0	9.7	9.7	
1983	<1>	7.7	7.7	3.7	3.7	3.8	3.8	4.6	4.6	9.6	9.6	
1984		11.0	10.7	6.9	6.7	4.0	4.1	-3	4.4	7.5	7.5	
1985		7.6	6.8	3.5	2.7	4.2	4.1	4.8	4.5	6.9	7.1	
<b>Quarterly changes:</b>												
1983	Q1	<1>	8.5	8.5	3.3	3.3	2.7	2.7	4.9	4.9	10.4	10.4
	Q2	<1>	12.3	12.3	9.4	9.4	3.9	3.9	3.5	3.5	10.1	10.1
	Q3	<1>	10.1	10.1	6.8	6.8	4.5	4.5	5.4	5.4	9.4	9.4
	Q4	<1>	10.6	10.6	5.9	5.9	3.5	3.5	3.8	3.8	8.5	8.5
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>	6.3	5.7	2.7	1.9	3.6	4.0	4.4	4.9	7.5	7.5
	Q4		7.4	5.5	3.4	1.3	4.1	4.3	4.5	4.4	7.3	7.3
1985	Q1		8.2	7.1	3.4	2.4	4.3	4.0	4.8	4.3	7.1	7.2
	Q2		7.3	7.0	3.3	3.2	4.4	4.0	4.8	4.3	7.0	7.1
	Q3		7.3	7.0	3.1	3.2	4.6	4.2	4.8	4.3	6.9	7.1
	Q4		7.3	6.8	2.9	2.8	4.7	4.3	4.9	4.4	6.8	7.0
<b>Two-quarter changes: &lt;2&gt;</b>												
1983	Q2	<1>	10.4	10.4	6.3	6.3	3.3	3.3	4.2	4.2	-5	-5
	Q4	<1>	10.3	10.3	6.4	6.4	4.0	4.0	4.6	4.6	-1.6	-1.6
1984	Q2	<1>	12.8	12.8	8.6	8.6	4.2	4.2	4.4	4.4	-1.0	-1.0
	Q4		6.8	5.6	3.0	1.6	3.9	4.2	4.4	4.7	-2	-2
1985	Q2		7.8	7.0	3.4	2.8	4.3	4.0	4.8	4.3	-3	-2
	Q4		7.3	6.9	3.0	3.0	4.6	4.2	4.8	4.3	-2	-1
<b>Four-quarter changes: &lt;3&gt;</b>												
1982	Q4	<1>	2.7	2.7	-1.5	-1.5	4.7	4.7	5.3	5.3	2.4	2.4
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		9.8	9.1	5.8	5.0	4.0	4.2	4.4	4.5	-1.2	-1.2
1985	Q4		7.5	7.0	3.2	2.9	4.5	4.1	4.8	4.3	-5	-3

&lt;1&gt; Actual.

&lt;2&gt; Percent change from two quarters earlier.

&lt;3&gt; Percent change from four quarters earlier.

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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.)

	1982				1983			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3026.0	3061.2	3080.1	3109.6	3173.8	3267.0	3346.6	3431.7
Final sales	3043.1	3072.1	3095.5	3170.8	3216.8	3286.4	3350.9	3419.0
Private	2412.2	2438.4	2439.2	2489.8	2538.0	2604.2	2661.1	2727.6
Domestic final purchases	2384.5	2402.9	2432.6	2483.5	2518.4	2610.7	2677.5	2757.4
Personal consumption expenditures	1931.3	1960.9	2001.3	2046.1	2070.4	2141.6	2181.4	2230.2
Goods	985.8	992.2	1007.0	1025.6	1034.6	1073.0	1095.8	1122.8
Services	945.4	968.6	994.2	1020.6	1035.8	1068.6	1085.7	1107.5
Gross private domestic investment	436.2	431.2	415.9	376.2	405.0	449.6	491.9	540.0
Residential structures	87.5	90.9	89.0	97.9	113.3	129.8	142.3	143.4
Business fixed investment	365.7	351.2	342.2	339.3	334.6	339.3	353.9	383.9
Change in business inventories	-17.0	-10.9	-15.3	-61.1	-42.9	-19.4	-4.3	12.7
Nonfarm	-20.9	-9.5	-11.1	-54.3	-32.6	-5.4	11.6	14.1
Net exports of goods and services <1>	27.7	35.5	6.6	6.3	19.6	-6.5	-16.4	-29.8
Exports	359.4	366.3	346.3	321.7	328.5	328.1	342.0	346.1
Imports	331.7	330.8	339.7	315.4	308.9	334.5	358.4	375.9
Gov't. purchases of goods and services	630.9	633.7	656.3	681.0	678.8	682.2	689.8	691.4
Federal <2>	249.8	245.0	261.6	279.4	273.0	270.5	269.2	266.3
State and local	381.1	388.7	394.7	401.6	405.8	411.6	420.6	425.1
Gross national product in constant (1972) dollars	1483.5	1480.5	1477.1	1478.8	1491.0	1524.8	1550.2	1572.7
Personal income	2536.3	2568.3	2594.2	2639.4	2662.8	2714.7	2763.3	2836.5
Wage and salary disbursements	1546.3	1564.2	1578.0	1586.4	1608.1	1642.1	1671.3	1715.4
Disposable personal income	2132.0	2156.8	2195.8	2237.5	2261.4	2302.9	2367.4	2428.6
Saving rate (percent)	6.7	6.3	6.1	5.8	5.7	4.2	5.0	5.3
Corporate profits with I.V.A. and C.C. Adj.	159.8	161.8	163.3	151.7	179.0	216.6	245.0	260.0
Corporate profits before tax	167.5	169.9	168.9	155.9	161.6	198.1	227.4	225.5
Federal government surplus or deficit (-) (N.I.A. basis)	-106.2	-112.1	-163.8	-210.7	-185.8	-167.3	-180.9	-180.5
High employment surplus or deficit (-) <3>	-36.9	-30.3	-71.5	-107.8	-81.0	-74.4	-102.3	-113.1
State and local government surplus or deficit(-) (N.I.A. basis)	32.6	34.2	33.3	31.4	34.0	43.8	47.4	51.2
Excluding social insurance funds	.5	.9	-1.0	-3.8	-2.0	6.9	9.5	12.0
Civilian labor force (millions)	109.4	110.2	110.5	110.8	110.7	111.3	112.1	112.0
Unemployment rate (percent)	8.8	9.4	10.0	10.6	10.4	10.1	9.4	8.5
Nonfarm payroll employment	90.4	89.9	89.2	88.7	88.8	89.6	90.4	91.7
Manufacturing	19.4	19.0	18.6	18.1	18.1	18.3	18.6	19.0
Industrial production (1967=100)	141.7	139.4	138.2	135.2	138.5	144.5	151.8	155.5
Capacity utilization: all manufacturing (percent)	72.9	71.6	71.1	69.0	70.7	73.9	77.4	78.9
Materials (percent)	73.0	70.7	69.4	67.2	70.1	73.5	77.5	79.6
Housing starts, private (million units, A.R.)	.88	.96	1.12	1.27	1.64	1.69	1.78	1.70
New auto sales (millions, A.R.)	8.12	7.53	7.78	8.57	8.46	9.10	9.22	9.94
Domestic models	5.90	5.53	5.56	6.08	6.06	6.81	6.92	7.29
Foreign models	2.22	1.99	2.22	2.49	2.40	2.28	2.31	2.65

> 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.

December 12, 1984

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

	1982				1983			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) Dollars</u>								
Gross national product	-4.7	- .8	- .9	.5	3.3	9.4	6.8	5.9
Final sales	-1.0	-1.5	- .3	5.5	1.1	6.4	4.9	4.2
Private	-1.4	- .9	-2.3	4.1	3.5	8.6	6.2	6.3
Domestic final purchases	.7	- .6	.6	4.8	4.0	12.1	6.9	9.7
Personal consumption expenditures	2.9	2.2	2.2	5.1	2.6	10.0	3.8	6.8
Goods	2.7	1.5	1.8	6.7	3.5	12.6	5.4	9.5
Services	3.1	3.0	2.7	3.4	1.5	7.3	2.1	3.8
Gross private domestic investment	-29.9	-8.1	-11.6	-29.9	34.0	52.5	38.4	37.0
Residential structures	-29.5	16.4	-8.2	51.1	64.4	78.5	31.6	4.0
Business fixed investment	-3.8	-17.6	-7.0	-5.7	.2	9.5	18.7	30.6
Gov't. purchases of goods and services	.8	-4.3	8.3	11.1	-8.1	-2.6	- .5	-4.3
Federal	3.6	-12.6	24.3	28.6	-17.3	-5.9	-5.3	-8.7
National defense	2.1	13.3	13.4	6.6	7.0	7.4	-1.9	9.2
State and local	-1.1	1.4	- .7	.2	-1.1	- .2	2.7	-1.4
Disposable personal income	-1.2	.8	1.2	3.7	2.1	3.4	7.7	8.2
<u>Current Dollars</u>								
Gross national product	- .3	4.7	2.5	3.9	8.5	12.3	10.1	10.6
Final sales	4.6	3.9	3.1	10.1	5.9	8.9	8.1	8.4
Private	4.4	4.4	.1	8.6	8.0	10.8	9.0	10.4
Domestic final purchases	5.2	3.1	5.0	8.6	5.7	15.5	10.6	12.5
Personal consumption expenditures	8.6	6.3	8.5	9.3	4.8	14.5	7.6	9.3
Goods	6.0	2.6	6.1	7.6	3.6	15.7	8.8	10.2
Services	11.4	10.2	11.0	11.1	6.1	13.3	6.6	8.3
Gross private domestic investment	-32.8	-4.5	-13.5	-33.1	34.3	51.9	43.2	45.3
Residential structures	-27.4	16.5	-8.1	46.4	79.4	72.3	44.4	3.3
Business fixed investment	-2.5	-14.9	-9.9	-3.3	-5.4	5.7	18.5	38.4
Gov't. purchases of goods and services	5.4	1.8	15.0	15.9	-1.3	2.0	4.5	.9
Federal	4.8	-7.5	30.0	30.1	-8.9	-3.6	-2.0	-4.3
National defense	6.9	17.4	19.5	17.9	8.0	9.8	3.3	13.2
State and local	5.8	8.2	6.3	7.2	4.2	5.8	9.0	4.4
Disposable personal income	4.3	4.7	7.4	7.8	4.3	7.5	11.7	10.7
Personal income	4.7	5.1	4.1	7.2	3.6	8.0	7.3	11.0
Wage and salary disbursements	3.8	4.7	3.6	2.1	5.6	8.7	7.3	11.0
Corporate profits with I.V.A. and C.C.Adj.	-44.2	5.1	3.8	-25.5	93.9	114.4	63.7	26.8
Corporate profits before tax	-57.7	5.9	-2.3	-27.4	15.4	125.8	73.6	-3.3
Nonfarm payroll employment	-2.7	-1.9	-3.1	-2.3	.5	3.4	3.7	5.8
Manufacturing	-9.2	-8.7	-8.9	-9.5	- .9	5.0	7.0	9.1
Nonfarm business sector								
Output per hour	2.5	-1.6	3.6	1.1	4.4	8.1	2.1	1.0
Compensation per hour	10.5	5.9	7.5	5.1	5.7	3.5	2.2	4.1
Unit labor costs	7.9	7.6	3.7	4.0	1.3	-4.2	.1	3.0
GNP implicit deflator <1>	4.6	5.6	3.4	3.4	5.0	2.6	3.1	4.4
Gross domestic business product								
fixed-weighted price index <2>	5.3	4.4	5.6	3.7	2.7	3.9	4.5	3.5
Excluding food and energy	5.6	6.7	5.2	3.9	4.9	3.5	5.4	3.8
Consumer price index (all urban)	3.8	5.5	7.3	1.5	.3	4.4	4.1	4.5
Industrial production	-11.8	-6.5	-3.4	-8.2	10.1	18.4	21.8	10.2

&lt;1&gt; Excluding the federal pay increase, the rate of change in 1982-Q4 was 3.0 percent.

&lt;2&gt; 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.)

	1984				Projected 1985			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross National Product	3553.3	3644.7	3695.2	3744.8	3809.2	3873.8	3940.2	4005.7
Final sales	3479.5	3594.1	3626.8	3697.4	3778.6	3843.9	3909.7	3976.9
Private	2775.1	2850.4	2864.8	2917.4	2981.5	3031.7	3081.3	3132.9
Domestic final purchases	2826.6	2909.1	2954.7	2999.1	3060.2	3119.4	3179.6	3235.7
Personal consumption expenditures	2276.5	2332.7	2360.8	2401.8	2449.4	2493.1	2538.1	2582.7
Goods	1152.2	1179.0	1179.6	1196.7	1218.7	1237.2	1255.9	1273.9
Services	1124.4	1153.7	1181.2	1205.1	1230.7	1255.9	1282.2	1308.8
Gross private domestic investment	623.8	627.0	662.3	644.7	641.4	656.2	672.0	681.8
Residential structures	151.2	155.6	155.4	153.4	157.4	162.9	168.4	169.9
Business fixed investment	398.8	420.8	438.5	443.9	453.4	463.4	473.1	483.1
Change in business inventories	73.8	50.6	68.5	47.4	30.6	29.9	30.5	28.8
Nonfarm	60.6	47.0	59.5	42.4	28.6	28.9	30.5	28.8
Net exports of goods and services <1>	-51.5	-58.7	-89.9	-81.7	-78.7	-87.7	-98.3	-102.8
Exports	358.9	362.4	369.3	367.0	372.7	377.5	387.1	394.6
Imports	410.4	421.1	459.2	448.7	451.4	465.1	485.4	497.3
Gov't. purchases of goods and services	704.4	743.7	762.0	780.0	797.1	812.2	828.4	844.0
Federal <2>	267.6	296.4	302.8	311.6	320.0	326.9	335.0	342.5
State and local	436.8	447.4	459.3	468.4	477.1	485.3	493.4	501.5
Gross national product in constant (1972) dollars	1610.9	1638.8	1646.5	1651.7	1661.6	1674.7	1687.9	1699.8
Personal income	2920.5	2984.5	3046.6	3104.2	3161.2	3213.8	3266.2	3328.0
Wage and salary disbursements	1755.7	1793.1	1819.5	1845.9	1879.8	1911.5	1943.2	1974.9
Disposable personal income	2502.2	2554.3	2606.1	2652.9	2701.8	2744.7	2787.0	2838.4
Saving rate (percent)	6.1	5.7	6.3	6.3	6.2	5.9	5.7	5.7
Corporate profits with I.V.A. and C.C. Adj.	277.4	291.2	281.4	273.3	273.4	276.8	281.5	284.3
Corporate profits before tax	243.3	246.2	223.6	213.5	209.4	211.3	215.0	215.3
Federal government surplus or deficit (-) (N.I.A. basis)	-161.3	-163.9	-176.6	-192.4	-195.6	-196.0	-195.6	-204.8
High employment surplus or deficit (-) <3>	-113.4	-129.8	-142.7	-157.1	-160.5	-162.5	-163.3	-172.9
State and local government surplus or deficit(-) (N.I.A. basis)	54.0	54.3	45.7	46.1	46.8	47.7	47.7	47.7
Excluding social insurance funds	13.5	12.4	2.4	2.2	2.3	2.7	2.2	1.7
Civilian labor force (millions)	112.6	113.6	113.7	114.2	114.7	115.2	115.8	116.3
Unemployment rate (percent)	7.9	7.5	7.5	7.3	7.2	7.1	7.1	7.0
Nonfarm payroll employment	92.8	93.8	94.6	95.4	96.1	96.6	97.2	97.7
Manufacturing	19.4	19.6	19.7	19.7	19.8	19.9	20.0	20.1
Industrial production (1967=100)	159.8	163.1	165.6	165.0	166.3	167.7	169.2	170.7
Capacity utilization: all manufacturing (percent)	80.7	81.8	82.5	81.6	81.6	81.6	81.6	81.6
Materials (percent)	81.6	82.7	82.9	82.1	82.1	82.2	82.4	82.4
Housing starts, private (million units, A.R.)	1.97	1.90	1.66	1.64	1.75	1.85	1.80	1.75
New auto sales (millions, A.R.)	10.46	10.68	10.32	10.15	10.55	10.95	11.15	11.20
Domestic models	8.16	8.26	7.97	7.40	8.10	8.40	8.50	8.45
Foreign models	2.30	2.42	2.34	2.75	2.45	2.55	2.65	2.75

&lt;1&gt; Balance of payments data and details underlying these estimates are shown in the International Developments section of this part of the Greenbook.

&lt;2&gt; Components of purchases and total receipts and total expenditures are shown in the Federal Sector Account table which follows.

&lt;3&gt; Estimates in table are evaluated at a 6 percent high employment unemployment rate.

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

	1984				Projected 1985			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	<u>Constant (1972) Dollars</u>							
Gross national product	10.1	7.1	1.9	1.3	2.4	3.2	3.2	2.8
Final sales	3.6	10.3	-1.5	3.5	4.4	3.4	3.2	3.1
Private	4.2	8.5	-2.0	3.3	4.8	3.4	3.1	3.0
Domestic final purchases	7.6	9.5	2.6	2.1	4.9	4.0	3.7	2.9
Personal consumption expenditures	4.6	7.9	.5	2.8	4.4	3.2	3.0	2.6
Goods	7.8	10.7	-1.5	2.5	5.4	3.7	3.3	2.7
Services	1.2	4.6	3.1	3.1	3.3	2.7	2.6	2.5
Gross private domestic investment	71.5	-2.2	25.7	-11.2	-4.7	6.0	6.4	2.9
Residential structures	20.8	1.3	-4.5	-7.7	7.1	10.5	9.8	-1.5
Business fixed investment	20.5	21.4	15.8	2.0	6.4	6.2	5.8	5.6
Gov't. purchases of goods and services	1.0	18.6	6.4	4.3	2.6	3.0	3.8	3.4
Federal	-2.8	45.4	7.3	6.3	2.6	4.2	6.0	5.2
National defense	3.8	12.0	-2.2	9.6	7.3	7.8	7.1	6.1
State and local	3.5	3.7	5.7	2.9	2.7	2.2	2.2	2.2
Disposable personal income	8.6	6.3	3.9	3.0	3.9	2.5	1.9	3.0
<u>Current Dollars</u>								
Gross national product	14.9	10.7	5.7	5.5	7.1	7.0	7.0	6.8
Final sales	7.3	13.8	3.7	8.0	9.1	7.1	7.0	7.1
Private	7.1	11.3	2.0	7.6	9.1	6.9	6.7	6.9
Domestic final purchases	10.4	12.2	6.4	6.2	8.4	8.0	7.9	7.2
Personal consumption expenditures	8.6	10.2	4.9	7.1	8.2	7.3	7.4	7.2
Goods	10.9	9.6	.2	5.9	7.6	6.2	6.2	5.9
Services	6.2	10.8	9.9	8.3	8.8	8.4	8.6	8.6
Gross private domestic investment	78.1	2.1	24.5	-10.2	-2.0	9.5	10.0	6.0
Residential structures	23.6	12.2	-1.5	-5.0	10.8	14.7	14.2	3.6
Business fixed investment	16.5	24.0	17.9	5.1	8.8	9.1	8.7	8.7
Gov't. purchases of goods and services	7.7	24.3	10.2	9.8	9.1	7.8	8.2	7.8
Federal	2.0	50.5	8.9	12.1	11.2	8.9	10.3	9.3
National defense	12.5	14.6	-1.7	14.7	17.3	12.3	12.0	10.6
State and local	11.5	10.1	11.1	8.1	7.7	7.1	6.9	6.7
Disposable personal income	12.7	8.6	8.4	7.4	7.6	6.5	6.3	7.6
Personal income	12.4	9.1	8.6	7.8	7.6	6.8	6.7	7.8
Wage and salary disbursements	9.7	8.8	6.0	5.9	7.6	6.9	6.8	6.7
Corporate profits with I.V.A. and C.C.Adj.	29.8	21.4	-12.8	-11.1	.1	5.2	6.9	4.1
Corporate profits before tax	35.5	4.9	-31.9	-17.0	-7.5	3.8	7.1	.6
Nonfarm payroll employment	4.8	4.5	3.3	3.8	2.6	2.5	2.3	2.1
Manufacturing	7.5	4.5	2.1	.8	2.0	2.2	1.8	1.8
Nonfarm business sector								
Output per hour	2.9	5.5	-1.7	-1.6	.3	1.2	1.2	1.0
Compensation per hour	6.1	3.7	3.8	3.8	4.5	4.3	4.5	4.7
Unit labor costs	3.1	-1.7	4.5	5.4	4.2	3.1	3.3	3.7
GNP implicit deflator <1>	4.4	3.3	3.7	4.1	4.5	3.6	3.7	3.9
Gross domestic business product								
fixed-weighted price index <2>	4.2	4.1	4.0	4.3	4.0	4.0	4.2	4.3
Excluding food and energy	3.4	5.4	4.9	4.4	4.3	4.3	4.3	4.4
Consumer price index (all urban)	5.0	3.7	3.5	4.5	4.0	4.1	4.4	4.6
Industrial production	11.5	8.6	6.3	-1.5	3.1	3.6	3.6	3.5

&lt;1&gt; Excluding Federal pay increase, the rate of change in 1984-Q1 is 4.0 percent and in 1985-Q1 is 4.0 percent.

&lt;2&gt; Uses expenditures in 1972 as weights.

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

	1978	1979	1980	1981	1982	1983	---Projected---	
							1984	1985
Gross national product	2163.9	2417.8	2631.7	2957.7	3069.2	3304.8	3659.5	3907.2
Final sales	2137.4	2403.5	2641.4	2931.7	3095.4	3318.3	3599.5	3877.3
Private	1705.5	1929.2	2103.7	2335.2	2444.9	2632.7	2851.9	3056.9
Domestic final purchases	1706.6	1915.9	2079.7	2307.2	2425.9	2641.0	2922.4	3148.7
Personal consumption expenditures	1346.5	1507.1	1668.0	1849.1	1984.9	2155.9	2343.0	2515.8
Goods	728.5	813.4	883.5	966.1	1002.6	1081.5	1176.9	1246.4
Services	618.0	693.7	784.5	883.0	982.2	1074.4	1166.1	1269.4
Gross private domestic investment	386.6	423.0	401.9	484.2	414.9	471.6	639.5	662.8
Residential construction	111.2	118.5	102.9	104.3	91.3	132.2	153.9	164.6
Business fixed investment	248.9	290.2	308.8	353.9	349.6	352.9	425.5	468.2
Change in business inventories	26.5	14.3	-9.8	26.0	-26.1	-13.5	60.1	30.0
Nonfarm	25.4	8.6	-4.5	18.2	-23.9	-3.1	52.4	29.2
Net exports of goods and services <1>	-1.1	13.2	23.9	28.0	19.0	-8.3	-70.5	-91.9
Exports	218.7	281.3	338.8	369.9	348.4	336.2	364.4	383.0
Imports	219.8	268.1	314.8	341.9	329.4	344.4	434.9	474.8
Gov't. purchases of goods and services	431.9	474.4	537.8	596.5	650.5	685.5	747.5	820.4
Federal <2>	153.6	168.3	197.0	228.9	258.9	269.7	294.6	331.1
State and local	278.3	306.0	340.8	367.6	391.5	415.8	453.0	489.3
Gross national product in constant (1972) dollars	1438.6	1479.4	1475.0	1512.1	1480.0	1534.7	1637.0	1681.0
Personal income	1732.7	1951.1	2165.3	2429.4	2584.6	2744.3	3014.0	3242.3
Wage and salary disbursements	1106.3	1237.6	1356.7	1493.1	1568.7	1659.2	1803.5	1927.4
Disposable personal income	1474.0	1650.2	1828.9	2041.7	2180.5	2340.1	2578.9	2768.0
Saving rate (percent)	6.1	5.9	6.0	6.7	6.2	5.0	6.1	5.9
Corporate profits with I.V.A. and C.C.Adj.	192.4	194.8	175.4	190.0	159.2	225.1	280.8	279.0
Corporate profits before tax	229.1	252.7	234.6	221.3	165.6	203.1	231.7	212.7
Federal government surplus or deficit (-) (N.I.A. basis)	-29.5	-16.1	-61.3	-64.2	-148.2	-178.6	-173.6	-198.0
High employment surplus or deficit (-)	-33.9	-20.8	-36.4	-31.3	-61.6	-92.7	-135.8	-164.8
State and local government surplus or deficit (-) (N.I.A. basis)	30.3	30.4	30.6	37.6	32.9	44.1	50.0	47.5
Excluding social insurance funds	10.0	6.8	3.5	7.8	-8	6.6	7.6	2.2
Civilian labor force (millions)	102.3	105.0	106.9	108.7	110.2	111.6	113.5	115.5
Unemployment rate (percent)	6.1	5.8	7.1	7.6	9.7	9.6	7.5	7.1
Nonfarm payroll employment (millions)	86.7	89.8	90.4	91.2	89.6	90.1	94.1	96.9
Manufacturing	20.5	21.0	20.3	20.2	18.8	18.5	19.6	20.0
Industrial production (1967=100)	146.1	152.5	147.0	150.9	138.6	147.6	163.4	168.5
Capacity utilization: all manufacturing (percent)	84.7	86.0	79.6	79.4	71.1	75.2	81.7	81.6
Materials (percent)	85.6	87.6	80.4	80.7	70.1	75.2	82.3	82.3
Housing starts, private (million units, A.R.)	2.00	1.72	1.30	1.10	1.06	1.70	1.79	1.79
New auto sales (millions, A.R.)	11.29	10.68	9.04	8.56	8.00	9.18	10.40	10.96
Domestic models	9.29	8.36	6.62	6.24	5.77	6.79	7.95	8.36
Foreign models	2.00	2.32	2.42	2.32	2.23	2.39	2.45	2.60

<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

	1978	1979	1980	1981	1982	1983	---Projected---	
							1984	1985
<u>Constant (1972) Dollars</u>								
Gross national product	5.0	2.8	-3	2.5	-2.1	3.7	6.7	2.7
Final sales	4.9	3.5	.5	1.5	-7	3.2	4.7	3.5
Private	5.6	4.0	.1	1.6	-1.3	4.1	5.0	3.3
Domestic final purchases	5.5	2.9	-1.0	2.2	-2	5.6	7.5	3.9
Personal consumption expenditures	4.5	2.7	.5	2.0	1.3	4.8	5.2	3.3
Goods	4.2	1.9	-1.4	1.7	.4	6.0	7.0	3.5
Services	4.8	3.7	2.7	2.3	2.5	3.4	3.1	3.1
Gross private domestic investment	10.5	-.2	-11.8	10.7	-15.9	13.7	31.4	1.3
Residential structures	2.8	-5.3	-20.3	-5.5	-14.8	41.6	12.0	2.8
Business fixed investment	12.8	7.3	-2.4	5.5	-4.6	2.5	19.6	7.3
Gov't. purchases of goods and services	2.0	1.3	2.2	.9	2.0	-.3	3.5	4.6
Federal	-.1	1.8	4.2	3.7	6.1	-.7	5.0	6.9
National defense	.5	2.6	3.9	5.0	7.6	7.1	5.4	6.8
State and local	3.3	1.1	1.0	-.6	-.6	.0	2.5	3.0
Disposable personal income	4.9	2.7	.6	2.7	.9	3.5	6.7	3.3
<u>Current Dollars</u>								
Gross national product	12.8	11.7	8.8	12.4	3.8	7.7	10.7	6.8
Final sales	12.8	12.4	9.9	11.0	5.6	7.2	8.5	7.7
Private	13.6	13.1	9.0	11.0	4.7	7.7	8.3	7.2
Domestic final purchases	13.4	12.3	8.5	10.9	5.1	8.9	10.7	7.7
Personal consumption expenditures	11.8	11.9	10.7	10.9	7.3	8.6	8.7	7.4
Goods	10.9	11.7	8.6	9.3	3.8	7.9	8.8	5.9
Services	12.9	12.2	13.1	12.6	11.2	9.4	8.5	8.9
Gross private domestic investment	19.3	9.4	-5.0	20.5	-14.3	13.7	35.6	3.7
Residential structures	16.1	6.6	-13.2	1.3	-12.4	44.7	16.4	7.0
Business fixed investment	21.3	16.6	6.4	14.6	-1.2	.9	20.6	10.0
Gov't. purchases of goods and services	9.7	9.8	13.4	10.9	9.0	5.4	9.0	9.8
Federal	7.1	9.6	17.1	16.2	13.1	4.2	9.2	12.4
National defense	8.0	11.5	17.3	17.2	16.8	11.7	10.0	12.3
State and local	11.2	9.9	11.4	7.9	6.5	6.2	8.9	8.0
Disposable personal income	12.2	12.0	10.8	11.6	6.8	7.3	10.2	7.3
Personal income	12.5	12.6	11.0	12.2	6.4	6.2	9.8	7.6
Wage and salary disbursements	12.5	11.9	9.6	10.1	5.1	5.8	8.7	6.9
Corporate profits with I.V.A. and C.C.Adj.	15.0	1.2	-9.9	8.3	-16.2	41.5	24.8	-.7
Corporate profits before tax	17.7	10.3	-7.1	-5.7	-25.2	22.7	14.0	-8.2
Nonfarm payroll employment	5.1	3.6	.6	.8	-1.7	.6	4.4	2.9
Manufacturing	4.2	2.6	-3.6	-.6	-6.9	-1.5	5.9	2.0
Nonfarm business sector								
Output per hour	.6	-1.5	-.7	1.5	.2	3.5	2.6	.5
Compensation per hour	8.6	9.0	10.3	9.6	8.0	4.9	4.2	4.2
Unit labor costs	8.0	10.7	11.1	8.0	7.7	1.4	1.7	3.7
GNP implicit deflator	7.4	8.6	9.2	9.6	6.0	3.8	3.8	4.0
Gross domestic business product								
fixed-weighted price index <1>	8.0	9.9	10.0	9.6	6.0	3.8	4.1	4.1
Excluding food and energy	7.8	8.6	8.5	9.4	7.0	4.6	4.4	4.5
Consumer price index (all urban)	7.6	11.3	13.5	10.3	6.1	3.2	4.3	4.1
Industrial production	5.8	4.4	-3.6	2.6	-8.1	6.4	10.7	3.1

&lt;1&gt; Uses expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS  
(Billions of dollars)

	Fiscal Year 1983*	Fiscal Year 1984*	FY1985 <sup>a</sup> /2/		CY 1983*	CY1984 <sup>c</sup> FRB Staff	FRB staff estimates							
			Admin. 1/	FRB Staff			Calendar quarters; not seasonally adjusted							
							1983 IV*	1984 I*	1984 II*	1984 III*	1984 IV	1985 I	1985 II	1985 III
Unified budget receipts	601	666	764	735	613	683	149	155	187	175	166	170	212	188
Unified budget outlays	796	842	911	936	804	868	213	209	211	208	240	231	235	231
Surplus/deficit(-), unified budget	-195	-175	-167	-201	-191	-185	-63	-54	-24	-33	-74	-61	-23	-43
Surplus/deficit(-), off-budget agencies <sup>3</sup>	-12	-10	-13	-14	-10	-12	1	-2	-4	-5	-1	-3	-5	-5
Combined deficit to be financed	-208	-185	-180	-215	-201	-197	-62	-57	-28	-38	-75	-64	-28	-48
Means of financing combined deficit:														
Net borrowing from public	212	171	178	197	187	195	36	49	31	54	61	57	34	45
Decrease in cash operating balance	-8	7	0	15	8	0	25	-2	1	-17	18	3	-5	0
Other <sup>4</sup>	3	8	2	7	6	4	1	10	-3	1	-4	5	-2	2
Cash operating balance, end of period	37	30	20	15	12	12	12	14	14	30	12	10	15	15
Memo: Sponsored agency borrowing <sup>5</sup>	-3	30	n.a.	21	2	32	3	6	9	12	5	6	5	5
<b>NIA Budget</b>							<b>Seasonally adjusted annual rates</b>							
Receipts	629	688	788	744	641	704	655	686	704	707	719	738	752	767
Expenditures	816	859	952	939	820	878	835	848	868	884	911	933	948	963
Purchases	273	283	337	323	270	295	266	268	296	303	312	320	327	335
Defense	196	215	252	240	201	221	207	213	221	220	228	237	244	251
Nondefense	77	68	84	83	69	74	59	54	76	82	84	83	83	84
All other expenditures	543	576	615	616	550	583	569	580	572	582	600	613	621	628
Surplus/deficit(-)	-186	-171	-164	-195	-179	-174	-180	-161	-164	-177	-192	-196	-196	-195
High employment surplus/deficit(-) evaluated at 6 percent unemployment	-91	-125	n.a.	-161	-93	-136	-113	-113	-130	-143	-157	-161	-163	-163
	*--actual		e--estimated				n.a.--not available							

1. OMB Mid-Session Review of the 1985 Budget, August 1984. More recent, unofficial OMB estimates show receipts of around \$745 billion, outlays of \$955 billion, and a deficit of roughly \$210 billion.
2. The CBO baseline budget estimates show revenues of \$751 billion, outlays of \$929 billion and a deficit of \$178 billion in fiscal year 1985 (The Economic and Budget Outlook: An Update, August 1984).

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.



Recent developments. M1 growth picked up in November to roughly a 9 percent pace, more than offsetting the contraction of this aggregate in October, but leaving it still in the lower half of the 1984 target range. Growth in M2 jumped to 15 percent in November, pushing this aggregate to the midpoint of its range; the strong growth in the nontransactions component of M2 appeared largely to reflect increased demand for money market mutual funds and MMDAs, returns on which have lagged the decline in market rates of interest. M3 also accelerated in November, bolstered primarily by the expansion in M2, and it moved further above its target range.

Short-term interest rates have moved down about 20 to 35 basis points since the November FOMC meeting, while long-term rates have registered smaller declines. Federal funds have traded most recently in the 8-1/2 to 9 percent area versus the 9-3/4 percent rate that prevailed in early November. The intermeeting lows were registered in late November after the cut from 9 to 8-1/2 percent in the discount rate confirmed market perceptions of an easing in monetary policy. Rates have backed up since that time, however, as hopes of further easing in policy have abated in light of stronger monetary figures and the strength of the November employment figures.

Debt of domestic nonfinancial sectors appears to have expanded more rapidly in October and November, paced by strong public sector borrowing. The U.S. Treasury raised more than \$40 billion from the public in October and November; over the quarter as a whole, the Treasury is expected to finance a combined deficit of \$75 billion by means of an \$18 billion reduction in cash balances and \$61 billion net borrowing from the public.

In the municipal sector, bond offerings have been unusually heavy of late, for reasons related to the Deficit Reduction Act, which reauthorized the issuance of housing revenue bonds and clarified legislative restrictions on private-purpose issues of tax-exempt debt. Sales of single-family mortgage revenue bonds have eased off from the record pace of the third quarter, but still averaged a strong \$1.4 billion in October and November. In addition, some tax-exempt revenue issues have been hurried to market before year-end to avoid either the volume limitations or the more severe arbitrage restrictions that go into effect January 1. The pressure of large supplies in the municipal bond markets has raised the ratio of tax-exempt to taxable yields to its highest level in 18 months.

Credit demands of nonfinancial businesses also have been large thus far in the fourth quarter. The decline in long-term interest rates since summer has prompted a huge volume of corporate bond issuance in both domestic and foreign markets. Indeed, bond issuance in the fourth quarter likely will be a record. Some of the recent bond issuance is merger-related, with proceeds being used to fund short-term debt taken on by acquiring companies earlier in the year. But corporate external funding requirements for investment and inventories likely also have been sizable, owing to slower growth in corporate cash flow. In addition, acquisitions and take-overs continue to boost short-term credit demands by businesses, especially at commercial banks.

Credit flows to households, which had diminished during the summer, appear to be stabilizing in the aggregate. With commitment rates on conventional mortgages until recently lagging the decline in other market rates, and given the reduced pace of housing activity, home mortgage debt formation

has slowed. In October, acquisitions of mortgage assets at thrift institutions edged down from low September levels. There are signs, however, of some revival in this sector. New commitments at S&Ls were up a bit in October, reversing a three-month downtrend, and the pace of real-estate lending at commercial banks strengthened in November. Over the intermeeting period, mortgage rates have moved down further, catching up with market yields, which may be spurring mortgage demand. A strong increase in consumer installment credit in October also ended a three-month deceleration in this measure. November data from commercial banks suggest another strong increase in consumer credit during that month.

Outlook. The staff expects that the pace of borrowing by domestic nonfinancial sectors will fall below recent levels during the early months of 1985. However, this drop-off in borrowing is in good part reflective of shifts in financial flows rather than in basic demands on the economy's savings, and consequently the staff anticipates that interest rates will fluctuate around recent levels over the winter months. The markets will remain sensitive to incoming economic and monetary data, and considerable attention likely will be focused on developments in the fiscal policy arena.

The staff is projecting that the Treasury's combined (on- and off-budget) deficit in the first quarter will total about \$61 billion, declining somewhat from the current quarter, as it typically does in the first calendar quarter of the year. On a seasonally adjusted basis, Treasury borrowing in the first quarter is expected to be large, but somewhat less than the huge fourth-quarter volume.

Debt issuance by state and local governmental units--for both public and private purposes--should drop after the current year-end rush; however,

much of the proceeds of recent issues have been temporarily invested in financial assets so there is little reason to anticipate reduced net credit market pressure from activity in the tax-exempt sector. Owing to the diminution in tax-exempt bond offerings, municipal rates should ease back a bit relative to taxable bond yields.

Business borrowing is likely to remain large; the staff foresees little change in the corporate financing gap in the first part of next year and there have been numerous announcements of potential merger transactions suggesting that this activity may continue to bolster business credit use in the near term. If mergers do in fact remain important, it is likely that net equity financing will continue negative. Given current interest rate levels, businesses may continue to borrow heavily in long-term markets, perhaps not quite so much as in the past couple of months.

The staff anticipates that a somewhat less brisk growth of household sector indebtedness will accompany the gradual pickup expected in homebuilding and consumer spending in the months ahead. With real interest rates remaining high, and employment and income growing less rapidly than in the earlier stages of the economic expansion, it seems likely that consumer and mortgage credit flows will begin to fall more into line with underlying spending levels. Nonetheless, even the anticipated moderation of household debt growth would imply further increases in the ratio of debt to disposable income.

## INTERNATIONAL DEVELOPMENTS

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Recent Developments. The trade-weighted average value of the dollar has risen nearly 4 1/2 percent since the last FOMC meeting, reversing most of the decline from its mid-October peak. The appreciation cannot be attributed to movements in nominal interest differentials, as dollar interest rates declined further relative to comparable foreign-currency yields during the intermeeting period.

. The Bundesbank was a seller in operations that were visible and induced sharp but transitory declines in the mark/dollar rate.

U.S.-chartered banks (domestic offices plus their foreign branches combined) reduced their gross claims on foreigners by nearly \$22 billion (about 5 percent) during the third quarter, following reductions of about \$4 billion in each of the previous two quarters. A considerable part of the third-quarter decline may have reflected the valuation effects of the dollar's appreciation, which reduced the dollar value of the outstanding stock of more than \$100 billion-equivalent in non-dollar denominated claims held by foreign branches. Claims on non-OPEC developing countries, primarily in Asia, declined by \$1.9 billion in the third quarter. Claims on the G-10 countries and off-shore banking centers combined declined by more than \$16 billion, principally reflecting reductions in interbank placements that can be ascribed in part to banks' desires to improve their capital/asset ratios.

A reduction in interbank claims was also the major component of the net capital inflow reported by banking offices located in the United States, which resumed in the third quarter following a small second-quarter net outflow. Federal Reserve data for October show that U.S. nonbanks reduced their holdings of Eurodollar deposits by almost \$5 billion, bringing the decline in these holdings since March to \$13 billion. Recent innovations aimed at attracting low-cost funds from abroad include the introduction since late October of foreign-targeted notes by the U.S. Treasury and two U.S. government agencies (four issues all together, totalling \$2.5 billion), about a dozen flotations since February of collateralized Eurobonds by savings and loans (totalling \$1.4 billion), and a sharp increase in floating rate note issues by U.S. banks and bank holding companies (\$3.5 billion from July through November, compared with \$0.4 billion in the first half of 1984).

The U.S. merchandise trade deficit declined markedly in October, largely reflecting a sharp drop in non-oil imports to a level well below the third-quarter average and also below the average for the first two quarters. Because of the volatility of the monthly import data, however, limited significance should be attached to this decline, despite the fact that it was broadly based across commodity categories. Exports for October were little changed from the third-quarter average.

Moderate economic expansion has continued in the major foreign industrial countries, although at an uneven pace. Real activity in Germany rebounded sharply in the third quarter following a strike-related second-quarter decline, while a third-quarter acceleration of

Canadian activity partly reflected temporary speed-ups in production and exports in anticipation of the September and October auto strikes. Activity in the United Kingdom has continued to be depressed by the coal-miners strike (now in its ninth month), with real activity virtually flat in the third quarter; in November the Bank of England reduced its money-market dealing rates in three steps totalling 1 percentage point, the last reduction taking place on the day after the cut in the Federal Reserve discount rate. Inflation rates in the foreign industrial countries have either remained steady at low levels (e.g., in Japan and Germany) or showed further declines.

Argentina and its bank advisory committee reached an agreement on December 2 on a financial package involving \$4.2 billion in new credits as well as a multi-year restructuring of debts now in arrears or maturing before the end of 1985. Yugoslavia's bank advisory committee reportedly has offered the country a four-year serial debt restructuring. Early approval by creditor banks of financial arrangements negotiated by bank advisory committees appears imminent for the Philippines but remains somewhat problematic for Venezuela, which has not made sufficient progress on the problem of private sector interest arrears. Brazil has begun to negotiate a multi-year rescheduling; it is likely that such an agreement will not involve any new money from banks in 1985 in light of the continued strengthening of Brazil's external performance. Mexico has recently adjusted the rate of crawl at which it is depreciating its currency in order to prevent the peso from becoming more overvalued; Mexico's public sector deficit

continues to be a source of concern, with both the 1984 outcome and the government's 1985 plan somewhat higher than earlier envisaged by the IMF.

Outlook. The staff's forecast for the U.S. current account deficit in 1984 and 1985 now stands at about \$105 and \$125 billion, respectively, little changed from the last Greenbook. The corresponding projection for the merchandise trade deficit is about \$115 billion in 1984 and \$125 billion in 1985. Underlying the forecast is a projection that real GNP growth through the end of 1985 will average about 2 3/4 percent (annual rate) in the foreign industrial countries and between 3 1/2 and 4 percent in the non-OPEC developing countries. It is also assumed that the OPEC countries will succeed in adjusting production to hold oil prices at or only slightly below their current levels. The staff views the present strength of the dollar as substantially above the average value that can be sustained over the long run. Although it is difficult to predict the speed and timing of the eventual decline in the dollar's value with much confidence, the staff continues to project a step in that direction during 1985 and has incorporated a moderate depreciation in the forecast.



DECEMBER 11, 1984

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

	1983	ANNUAL		1983		1984				1985			
		1984-P	1985-P	Q3	Q4	Q1	Q2	Q3	Q4-P	Q1-P	Q2-P	Q3-P	Q4-P
1. <u>GNP EXPORTS AND IMPORTS</u> 1/													
CURRENT \$, NET	-8.2	-70.5	-91.9	-16.4	-29.8	-51.5	-58.7	-89.9	-81.7	-78.7	-87.7	-98.3	-102.8
EXPORTS OF G+S	336.2	364.4	383.0	342.0	346.1	358.9	362.4	369.3	367.0	372.7	377.5	387.1	394.6
IMPORTS OF G+S	344.4	434.9	474.8	358.4	375.9	410.4	421.1	459.2	448.7	451.4	465.1	485.4	497.3
CONSTANT 72 \$, NET	12.6	-17.4	-26.2	11.9	1.9	-8.3	-11.5	-26.6	-23.1	-23.5	-25.6	-27.9	-27.9
EXPORTS OF G+S	139.5	145.9	148.1	141.6	141.0	144.9	144.7	147.8	146.2	146.7	146.9	149.0	150.1
IMPORTS OF G+S	126.9	163.3	174.4	129.7	139.1	153.2	156.2	174.4	169.3	170.1	172.4	176.9	178.0
2. <u>U.S. MERCHANDISE TRADE BALANCE</u> 2/	-61.1	-114.0	-126.0	-70.0	-77.6	-103.4	-102.9	-131.6	-118.1	-113.3	-122.4	-131.7	-136.4
EXPORTS	200.3	219.9	232.6	201.7	207.3	215.7	218.4	221.5	223.9	228.6	231.0	233.4	237.5
AGRICULTURAL	36.6	37.3	35.9	37.2	39.2	41.2	37.1	35.9	35.1	35.8	35.9	35.7	36.3
NONAGRICULTURAL	163.6	182.6	196.7	164.5	168.1	174.5	181.3	185.6	188.7	192.8	195.1	197.7	201.3
IMPORTS	261.3	333.9	358.6	271.8	284.9	319.2	321.3	353.1	342.0	341.9	353.4	365.1	373.9
PETROLEUM AND PRODUCTS	53.8	58.5	62.4	63.7	57.1	55.4	59.6	57.9	61.1	59.5	61.0	63.8	65.2
NONPETROLEUM	207.5	275.4	296.2	208.1	227.8	263.8	261.7	295.3	280.9	282.4	292.3	301.3	308.8
3. <u>U.S. CURRENT ACCOUNT BALANCE</u>	-41.6	-102.7	-125.2	-47.4	-68.8	-78.7	-97.6	-119.8	-114.8	-109.9	-119.9	-132.0	-139.1
OF WHICH: NET INVESTMENT INCOME	23.5	19.8	9.6	28.7	20.5	31.0	14.6	20.3	13.3	11.3	10.8	8.5	7.6
4. <u>FOREIGN OUTLOOK</u> 3/													
REAL GNP--TEN INDUSTRIAL 4/	1.5	2.9	2.7	2.6	4.0	4.4	-0.8	4.8	2.9	2.6	2.8	2.7	2.6
REAL GNP--NONOPEC LDC 5/	0.4	2.7	3.7	0.9	1.3	4.2	3.4	3.5	3.6	3.7	3.9	4.1	4.2
CONSUMER PRICES--TEN IND. 4/	5.7	4.9	4.3	5.3	5.5	5.3	4.8	2.5	4.6	4.3	4.8	4.3	4.6

1/ NATIONAL INCOME 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; CPI data are NSA.

5/ WEIGHTED BY SHARE IN NONOPEC LDC GNP.

P/ PROJECTED