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Strictly Confidential (FR) Class II FOMC

August 13, 1986

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee

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

Recent developments. Economic activity still is expanding, but unevenly and without much overall vigor. Apart from fluctuations in energy, recent price increases have continued to be generally moderate.

Industrial production fell 1/2 percent in June, and preliminary indications are for some further decline in July. About half of the June drop was strike-related; the remainder reflected small declines for a wide variety of products. Labor market data for July suggest continued weakness in a number of durable goods sectors. In addition, oil and gas drilling fell again in July, but, as in June, at a slower pace than in previous months.

Payroll employment, on a strike-adjusted basis, rose 240,000 in July. Hiring was up in construction and remained strong in the trade and service sectors. However, manufacturing employment (strike-adjusted) fell in July for the sixth month in a row, bringing the cumulative losses in this sector to 175,000 since January. The civilian unemployment rate dipped to 6.9 percent in July, toward the lower end of the range of the past year.

Consumer spending, in real terms, rose at an annual rate of nearly 6 percent in the second quarter and appears to be off to a relatively good start in the third quarter. According to the Census advance estimates, nominal sales at the retail control group of stores (i.e., total sales excluding autos, gasoline, and nonconsumption items) were up 0.7 percent in July. Total car sales, however, slipped to a 10.9 million unit rate in July, as a drop in sales of domestic models more than offset a strong increase in foreign car sales. Total personal income, in real terms, grew at close to a 7 percent annual rate in the second quarter. The strong gain resulted partly from declines in consumer prices and some special factors—such as an unusually high level of farm subsidy payments. Real wages and salaries grew more slowly—roughly 4 percent at an annual rate.

Residential construction activity has continued to expand, reflecting the rise in housing starts earlier this year. Recently, however, the level of starts has tapered off from the exceptional pace of the early spring, owing to a decline among multifamily units; rental vacancy rates in the multifamily sector are extraordinarily high, and the effect of the heavy issuance of mortgage revenue bonds in late 1985 has waned. Sales of single-family homes also weakened in May and June, but from an unsustainable April peak, and demand in this sector of the market appears to be holding up reasonably well.

Business investment in structures declined sharply in the first half of 1986, and advance indicators point to further contraction in the near-term. In particular, new commitments for nonresidential construction have been on a downward trend for several months, and oil drilling activity--a substantial depressant of structures outlays in the first half--seems likely to fall further in the third quarter, though the rig count has dropped much less sharply of late. Although orders for nondefense capital goods were up a little in June, they have not broken out of their sideways trend of recent quarters.

The inventory data for the second quarter, while still incomplete, currently point to a marked slowdown in the rate of accumulation, as auto dealers pared stocks slightly after two quarters of rapid accumulation. Excluding autos, inventories in the nonfarm sector grew at about the same pace as in the first quarter. As has been true for some time, inventory-sales ratios appear to be quite low in manufacturing and a bit on the high side in trade, though even in trade, obvious imbalances generally are not apparent outside of the auto sector.

Wage increases appear to have slowed further this year, although the reported rate of change and the degree of slowdown vary from measure to measure. The employment cost index, the most comprehensive measure, indicates that compensation in the nonfarm business sector rose 3-3/4 percent at an annual rate during the first half of 1986; this index had risen 3.9 percent in 1985. Other wage and compensation measures generally show a smaller rate of increase--and a somewhat larger deceleration--in the first half of the year.

Except for a June rebound in consumer energy prices, the recent price data showed continued restraint through midyear. The producer price index was unchanged in June, and, excluding energy, the consumer price index was up only 0.2 percent. Excluding both food and energy, the rate of increase in the CPI in the second quarter was around 3 percent--down a full percentage point from the first quarter. In the commodity markets, the price of crude oil fell through much of July, but then rose sharply in the wake of an accord by OPEC to temporarily restrain production. In agriculture, the lowering of price supports this summer has led to dramatic declines in the prices of many farm crops; livestock and poultry prices, in contrast, have moved higher in response to reduced hog marketings and, in the case of poultry, heat and drought losses in the Southeast. The prices of gold and platinum have soared recently, mainly reflecting concern that supplies from South Africa might be reduced or cut off.

Outlook. The staff is expecting output to pick up in coming months, with real GNP growth averaging about 3 percent at an annual rate in the second half of 1986. In 1987, real growth is expected to be just a little more than 3 percent.

A projected improvement in the U.S. trade position is expected to be a key element supporting growth in domestic production over the next year and a half, with net exports projected to account for about one-third of the growth in real GNP. Rising import prices are expected to restrain the growth in U.S. demand for foreign goods; in addition, with foreign economies expected to expand at a moderate pace and U.S. goods having become more competitive in world markets, exports should grow more rapidly than in recent quarters.

In contrast, growth in domestic demand is expected to be relatively sluggish over the next year and a half. Gross domestic purchases, which rose 4 percent in 1985 and at an annual rate of 3 percent in the first half of this year, are expected to slow further--to around a 2 percent rate of growth in the second half of this year and in 1987. Consumer spending is projected to continue expanding, but much less rapidly than in the first half of 1986. In addition, business investment spending is expected to edge down further in the near-term and to register only a small increase in 1987; although oil drilling should bottom out, office construction appears likely to trend down for some time. In the housing sector, single-family building is expected to rise slightly over the forecast horizon; however, multifamily starts are projected to fall further in reaction to high vacancy rates and assumed tax law changes. Federal purchases are expected to rise moderately in the third quarter and then flatten out in subsequent quarters.

The rate of inflation is expected to edge up in coming quarters, but, nevertheless, remain moderate. Consumer energy prices are projected to decline further in the current quarter, and then to rise somewhat in subsequent quarters as oil prices move back up to around $16 per barrel; even so, the indirect effects of past declines are expected to continue damping inflation. In the food sector, higher livestock prices are expected to boost food prices in the near term, but low grain prices should be an effective anchor preventing any sustained acceleration. Prices for nonoil imports, which have shown some increase in recent quarters, are expected to accelerate further in the second half and to continue rising rapidly in 1987. Overall, the GNP fixed-weighted price index, which rose at about a 2 percent rate in the first half, is expected to increase at a 2-1/2 percent rate in the second half and 3-1/4 percent in 1987.

The policy assumptions that underlie these forecasts of activity and inflation have changed only a little since the last Greenbook. Growth in M2 and M3 is now expected to be in the upper half of the ranges established by the FOMC for 1986 and well within the tentative 1987 ranges; interest rates are not expected to change substantially from current levels. Fiscal policy still is expected to shift toward restraint over the coming year. The fiscal 1986 deficit is now projected to reach a record $225 billion, as spending growth has been greater than previously assumed.

For fiscal 1987 the deficit is expected to fall to just under $170 billion, large reflecting spending cuts aimed at reaching the Gramm-Rudman-Hollings target, as well as added revenue from tax reform.

Details of the forecast are shown in the accompanying tables.

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STAFF GNP PROJECTIONS

Percent changes, annual rate

	Nominal GNP		Real GNP		GNP fixed-weighted price index		GNP deflator		Unemployment rate (percent)	
	7/2/86	8/13/86	7/2/86	8/13/86	7/2/86	8/13/86	7/2/86	8/13/86	7/2/86	8/13/86
Annual changes:										
1984 <1>	11.0	10.5	6.5	6.4	4.3	4.0	4.1	3.8	7.5	7.5
1985 <1>	5.7	6.2	2.2	2.7	3.6	3.7	3.3	3.3	7.2	7.2
1986	4.9	5.4	2.2	2.7	2.8	2.8	2.7	2.7	7.1	7.0
1987	5.9	5.7	3.1	3.1	3.0	2.9	2.7	2.6	6.7	6.7
Quarterly changes:										
1985 Q1 <1>	6.9	6.8	3.7	3.1	3.5	4.2	3.0	3.7	7.3	7.3
Q2 <1>	4.5	5.8	1.1	2.3	3.6	3.6	3.3	3.3	7.3	7.3
Q3 <1>	5.8	6.8	3.0	4.1	2.7	2.8	2.9	2.5	7.2	7.2
Q4 <1>	4.3	5.8	.7	2.1	3.9	4.0	3.3	3.6	7.0	7.0
1986 Q1 <1>	5.7	6.2	2.9	3.8	2.5	2.5	2.9	2.5	7.1	7.1
Q2 <1>	4.0	3.2	1.5	1.1	2.0	1.8	2.4	2.1	7.2	7.2
Q3	4.8	5.0	2.7	2.5	2.3	2.5	2.0	2.5	7.1	7.0
Q4	6.0	5.7	3.7	3.6	2.7	2.3	2.2	2.0	6.9	6.9
1987 Q1	6.3	6.0	3.4	3.3	3.3	3.2	2.9	2.6	6.8	6.8
Q2	6.3	6.1	3.2	3.2	3.3	3.2	3.0	2.8	6.7	6.7
Q3	6.3	6.1	3.0	3.2	3.4	3.2	3.2	2.9	6.6	6.7
Q4	6.6	6.4	3.0	3.2	3.7	3.3	3.5	3.2	6.6	6.6
Two-quarter changes: <2>										
1985 Q2 <1>	5.7	6.3	2.4	2.7	3.5	3.9	3.1	3.5	.1	.1
Q4 <1>	5.0	6.3	1.9	3.1	3.4	3.2	3.1	3.1	-.3	-.3
1986 Q2 <1>	4.8	4.7	2.2	2.4	2.3	2.3	2.6	2.3	.2	.2
Q4	5.4	5.4	3.2	3.0	2.5	2.4	2.1	2.2	-.3	-.3
1987 Q2	6.3	6.0	3.3	3.2	3.3	3.2	2.9	2.7	-.2	-.2
Q4	6.4	6.3	3.0	3.2	3.5	3.3	3.3	3.0	-.1	-.1
Four-quarter changes: <3>										
1984 Q4 <1>	9.0	8.5	4.7	4.6	4.2	3.9	4.1	3.6	-1.3	-1.3
1985 Q4 <1>	5.4	6.3	2.1	2.9	3.5	3.6	3.1	3.3	-.2	-.2
1986 Q4	5.1	5.0	2.7	2.7	2.4	2.4	2.4	2.3	-.1	-.1
1987 Q4	6.4	6.2	3.2	3.2	3.4	3.3	3.1	2.9	-.3	-.3

<1> Actual.
<2> Percent change from two quarters earlier.
<3> Percent change from four quarters earlier.

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
(seasonally adjusted; annual rate)

	Units	1985 Q3	1985 Q4	1986 Q1	1986 Q2	1986 Q3 (Projection)	1986 Q4 (Projection)	1987 Q1 (Projection)	1987 Q2 (Projection)	1987 Q3 (Projection)	1987 Q4 (Projection)
EXPENDITURES											
Nominal GNP	Billions of $	4030.5	4087.7	4149.2	4182.3	4233.5	4292.9	4355.7	4420.7	4486.8	4557.4
Real GNP	Billions of 82$	3603.8	3622.3	3655.9	3665.7	3688.0	3721.0	3751.2	3780.9	3810.5	3840.3
Real GNP	Percent change	4.1	2.1	3.8	1.1	2.5	3.6	3.3	3.2	3.2	3.2
Gross domestic purchases		4.6	4.0	3.0	3.2	1.5	2.5	2.0	2.0	1.8	1.9
Final sales		6.1	2.7	-1.3	3.4	3.0	3.2	3.3	3.1	3.1	3.1
Private dom. final purchases		4.8	3.4	.9	5.1	1.9	2.3	2.3	2.2	1.9	1.9
Personal consumption expend.		5.3	1.7	3.6	5.9	2.4	2.7	2.4	2.4	1.9	1.7
Durables		23.8	-11.1	-1.8	14.8	2.7	2.5	2.6	2.5	1.8	1.7
Nondurables		1.2	1.6	6.5	7.1	2.3	2.2	2.2	2.2	1.9	1.5
Services		3.2	6.0	3.2	2.5	2.5	3.0	2.5	2.6	1.9	1.8
Business fixed investment		.1	12.5	-15.1	-2.6	-3.6	.0	2.7	3.0	3.1	2.7
Producers' durable equipment		2.6	18.7	-17.0	17.1	.3	2.5	4.0	4.0	4.0	4.0
Nonresidential structures		-4.6	.3	-10.8	-35.7	-12.6	-6.2	-.5	.5	.6	-.6
Residential structures		11.7	3.4	11.0	15.4	9.0	3.9	.1	-2.9	-1.2	2.8
Exports		-5.8	8.2	7.1	3.0	10.1	13.0	11.9	12.1	15.5	14.2
Imports		.3	23.3	.2	20.1	.7	1.7	-.3	.7	2.7	2.3
Government purchases		13.9	10.0	-12.3	7.0	2.3	.9	.3	.7	1.5	1.3
Federal		26.0	22.7	-27.5	6.0	4.0	.6	-1.2	-.6	.9	.3
Defense		15.8	-4.7	-1.0	15.6	5.1	1.0	-.8	-.2	1.1	.8
State and local		5.1	.3	2.6	7.7	1.0	1.1	1.6	1.6	1.9	2.0
ange in business inventories	Billions of 82$	.7	-5.2	39.9	19.6	15.0	19.0	19.5	20.5	21.0	22.0
onfarm	Billions of 82$	1.4	16.1	37.0	12.1	11.5	19.0	19.5	20.5	21.0	22.0
exports	Billions of 82$	-113.8	-132.0	-125.9	-146.3	-138.2	-128.7	-117.1	-106.3	-94.5	-82.8
Nominal GNP	Percent change	6.8	5.8	6.2	3.2	5.0	5.7	6.0	6.1	6.1	6.4
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	97.9	98.7	99.4	99.9	100.4	101.0	101.6	102.1	102.7	103.2
Unemployment rate	Percent*	7.2	7.0	7.1	7.2	7.0	6.9	6.8	6.7	6.7	6.6
Industrial production index	Percent change	2.0	1.9	.7	-2.9	-2.5	3.4	3.4	3.3	3.3	3.4
Capacity utilization rate-mfg.	Percent*	80.3	80.0	79.9	79.1	78.3	78.5	78.8	79.0	79.2	79.4
Housing Starts	Millions	1.69	1.77	2.00	1.91	1.75	1.70	1.65	1.65	1.67	1.70
Auto sales	Millions	12.31	10.24	10.65	11.22	11.20	10.70	10.85	10.90	10.90	10.90
Domestic	Millions	9.40	6.84	7.84	8.18	8.06	7.50	7.80	7.80	7.80	7.80
Foreign	Millions	2.90	3.40	2.81	3.05	3.14	3.20	3.05	3.10	3.10	3.10
INCOME AND SAVING											
Nominal personal income	Percent change	3.0	7.4	6.0	5.6	3.1	6.8	5.9	6.5	6.8	6.8
Real disposable income	Percent change	-4.0	2.6	6.5	7.2	-.5	2.7	2.2	1.8	2.3	2.1
Personal saving rate	Percent*	4.2	4.4	5.0	5.2	4.5	4.5	4.4	4.2	4.2	4.3
Corp. profits with IVA & CCAdj	Percent change	36.2	-13.7	16.0	20.6	5.8	2.9	-4.7	-1.7	-1.7	.9
Profit share of GNP	Percent*	7.4	7.0	7.1	7.4	7.4	7.4	7.2	7.1	6.9	6.8
Federal govt. surplus/deficit	Billions of $	-197.5	-217.6	-201.6	-228.7	-187.4	-191.7	-173.6	-162.0	-154.8	-145.4
State and local govt. surplus		59.5	62.5	70.0	60.9	57.4	58.6	59.9	60.9	61.5	61.5
PRICES AND COSTS											
GNP implicit deflator	Percent change	2.5	3.6	2.5	2.1	2.5	2.0	2.6	2.8	2.9	3.2
GNP fixed-weight price index		2.8	4.0	2.5	1.8	2.5	2.3	3.2	3.2	3.2	3.3
Cons. & fixed invest. prices		2.7	4.3	1.6	-.1	2.4	3.4	4.0	3.7	3.6	3.5
CPI		2.6	4.3	1.5	-1.7	1.8	3.6	4.6	3.7	3.7	3.7
Exc. food and energy		3.5	4.9	4.3	3.4	3.5	3.7	4.0	4.1	4.3	4.4
nfarm business sector											
Output per hour		2.2	-3.5	4.3	1.7	1.1	1.8	1.2	1.1	.9	1.0
Compensation per hour		3.2	3.7	3.1	2.2	2.9	3.1	3.5	3.3	3.5	3.7
Unit labor costs		1.0	7.4	-1.2	.5	1.8	1.3	2.3	2.2	2.6	2.7

* Not at an annual rate.

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
(seasonally adjusted; annual rate)

August 13, 1986

	Units	1979	1980	1981	1982	1983	1984	1985	Projection 1986	Projection 1987
EXPENDITURES										
Nominal GNP	Billions of $	2508.2	2732.0	3052.6	3166.0	3405.7	3765.0	3998.1	4214.5	4455.2
Real GNP	Billions of 82$	3192.4	3187.1	3248.8	3166.0	3279.1	3489.9	3585.2	3682.6	3795.7
Real GNP	Percent change*	.6	-.1	.6	-1.9	6.5	4.6	2.9	2.7	3.2
Gross domestic purchases		-.4	-1.1	.8	-.8	8.4	5.9	3.9	2.5	1.9
Final sales		2.2	-.2	.1	.3	3.7	4.4	4.0	2.1	3.1
Private dom. final purchases		1.3	-1.7	-.3	.8	7.7	5.3	4.2	2.6	2.1
Personal consumption expend.		1.4	-.1	.2	2.9	5.4	3.6	3.5	3.7	2.1
Durables		-3.8	-5.6	-3.3	9.0	14.7	8.8	6.2	4.4	2.2
Nondurables		.8	-1.4	.5	1.8	4.4	2.2	2.0	4.5	1.9
Services		3.5	2.4	.9	2.3	3.9	3.3	3.9	2.8	2.2
Business fixed investment		5.0	-4.8	5.6	-11.3	10.8	14.7	6.5	-5.5	2.9
Producers' durable equipment		1.6	-6.5	2.2	-12.5	20.9	16.0	8.1	.0	4.0
Nonresidential structures		12.0	-1.8	11.7	-9.1	-4.8	12.1	3.3	-17.2	.0
Residential structures		-7.2	-14.2	-22.4	4.9	38.1	5.3	7.8	9.8	-.3
Exports		13.7	.5	2.4	-13.8	5.8	5.5	-3.2	8.2	13.4
Imports		3.4	-8.8	4.9	-5.9	23.8	16.5	5.8	5.4	1.3
Government purchases		.1	1.0	2.9	3.8	-2.7	7.7	8.4	-.8	.9
Federal		-.3	3.1	9.5	8.2	-8.1	14.2	14.3	-5.3	-.1
Defense		3.3	3.1	7.6	8.8	5.1	6.8	5.9	5.0	.2
State and local		.4	-.3	-1.3	.6	1.5	3.1	3.7	3.1	1.8
Change in business inventories	Billions of 82$	15.0	-6.9	23.9	-24.5	-6.4	59.2	9.0	23.4	20.8
Nonfarm	Billions of 82$	10.4	-2.3	19.0	-23.1	-.1	54.3	10.9	19.9	20.8
Net exports	Billions of 82$	3.6	57.0	49.4	26.3	-19.9	-83.6	-108.2	-134.8	-100.2
Nominal GNP	Percent change*	9.5	9.9	9.3	3.1	10.4	8.5	6.3	5.0	6.2
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	89.8	90.4	91.2	89.6	90.2	94.5	97.6	100.2	102.4
Unemployment rate	Percent	5.8	7.1	7.6	9.7	9.6	7.5	7.2	7.0	6.7
Industrial production index	Percent change*	.9	-.8	-1.0	-7.7	14.3	7.2	1.8	-.4	3.3
Capacity utilization rate-mfg.	Percent	84.6	79.2	78.3	70.3	74.0	80.8	80.3	78.9	79.1
Housing Starts	Millions	1.72	1.30	1.10	1.06	1.71	1.76	1.74	1.84	1.67
Auto sales	Millions	10.68	9.04	8.56	8.00	9.18	10.43	11.09	10.94	10.89
Domestic	Millions	8.36	6.62	6.24	5.77	6.77	7.97	8.24	7.89	7.80
Foreign	Millions	2.32	2.42	2.32	2.23	2.41	2.46	2.84	3.05	3.09
INCOME AND SAVING										
Nominal personal income	Percent change*	11.4	12.0	9.2	5.3	7.8	8.4	6.1	5.4	6.5
Real disposable income	Percent change*	.5	1.1	.7	1.0	5.1	4.2	1.9	3.9	2.1
Personal saving rate	Percent	6.8	7.1	7.5	6.8	5.4	6.3	5.1	4.8	4.3
Corp. profits with IVA & CCAdj	Percent change*	-10.7	-6.8	2.3	-19.1	70.1	6.6	7.8	11.1	-1.8
Profit share of GNP	Percent	8.0	6.5	6.2	4.7	6.3	7.0	7.0	7.4	7.0
Federal govt. surplus/deficit	Billions of $	-16.1	-61.3	-63.8	-145.9	-176.0	-170.0	-198.0	-202.3	-159.0
State and local govt. surplus		27.6	26.8	34.1	35.1	47.5	68.5	61.7	61.7	60.9
PRICES AND COSTS										
GNP implicit deflator	Percent change*	8.9	9.9	8.7	5.2	3.6	3.6	3.3	2.3	2.9
GNP fixed-weight price index		8.8	9.8	8.5	5.0	3.9	3.9	3.6	2.4	3.3
Cons. & fixed invest. prices		9.5	10.1	8.2	4.4	3.3	3.6	3.4	1.8	3.7
CPI		12.7	12.5	9.6	4.5	3.3	4.1	3.5	1.3	3.9
Exc. food and energy		10.7	12.2	10.2	5.2	4.3	4.8	4.3	3.7	4.2
Nonfarm business sector										
Output per hour		-2.7	1.0	-.6	1.0	3.6	1.0	.2	2.2	1.0
Compensation per hour		9.7	10.9	8.3	7.3	3.3	4.3	3.9	2.8	3.5
Unit labor costs		12.7	9.8	9.0	6.2	-.3	3.2	3.7	.6	2.4

* Percent changes are from fourth quarter to fourth quarter.

FEDERAL SECTOR ACCOUNTS
(Billions of dollars)

	Fiscal Year 1985*	FY1986e Admin 1/	FY1986e FRB Staff	FY1987e Admin 1/	FY1987e FRB Staff	CY 1985*	CY1986e FRB Staff	1985 IV*	1986 I*	1986 II	1986 III	1986 IV	1987 I	1987 II	1987 III
									FRB Staff Estimates						
								Not seasonally adjusted							
Budget receipts 2/	734	765	768	831	836	745	777	177	180	215	197	185	197	243	210
Budget outlays 2/	946	995	993	975	1003	961	992	252	241	245	255	252	251	251	250
Surplus/deficit(-) to be financed 2/	-212	-230	-225	-144	-167	-216	-216	-75	-61	-30	-58	-66	-54	-8	-39
Means of financing deficit:															
Borrowing from public	197	235	231	144	168	224	197	91	37	51	52	56	49	18	45
Cash balance decrease	13	-3	-7	0	-6	-13	18	-14	19	-12	0	12	-3	-5	-10
Other 3/	1	-2	1	0	5	5	1	-2	5	-8	5	-2	8	-5	4
Cash operating balance, end of period	17	20	24	20	30	31	13	31	12	25	24	13	15	20	30
Memo: Sponsored agency borrowing 4/	20	n.a.	13	n.a.	21	20	12	5	-2	5	5	4	5	6	6
NIPA Federal Sector								Seasonally adjusted annual rates							
Receipts	771	n.a.	814	n.a.	879	787	827	806	800	811	840	858	871	886	901
Expenditures	963	n.a.	1023	n.a.	1050	985	1030	1023	1002	1040	1027	1050	1045	1048	1056
Purchases	341	n.a.	368	n.a.	378	354	366	381	356	365	369	374	377	379	382
Defense	254	n.a.	274	n.a.	291	259	278	268	266	278	282	287	290	292	294
Nondefense	88	n.a.	94	n.a.	87	95	88	113	89	87	87	87	87	87	88
All other expend.	621	n.a.	655	n.a.	672	631	664	643	646	675	658	676	668	669	674
Surplus/deficit(-)	-191	n.a.	-209	n.a.	-171	-198	-202	-218	-202	-229	-187	-192	-174	-162	-155
High-employment surplus/ deficit(-) evaluated at 6 percent unemp.	-151	n.a.	-172	n.a.	-139	-159	-166	-180	-167	-190	-149	-156	-141	-132	-127

*--actual e--estimated n.a.--not available

Note: Details may not add to totals due to rounding

1. Mid-Session Review of the 1987 Budget (August 1987). The Congressional Budget Office baseline estimates published in August indicated receipts of $767 billion and $828 billion, and outlays of $991 billion and $1012 billion in FY1986 and FY1987, respectively.
2. Includes outlays formerly classified as off-budget (e.g. Federal Financing Bank and Strategic Petroleum Reserve) and social security receipts and outlays classified as off-budget under current law.
3. Checks issued less checks paid, accrued items, and other transactions.
4. 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 payment basis. The Administration's definition of borrowing by these agencies is somewhat broader.

Recent Developments. The discount rate was cut one-half percentage point shortly after the July FOMC meeting. In part because that reduction was widely anticipated, however, other interest rates generally have not posted comparable declines over the intermeeting period. Indeed, while yields on 3- to 6-month money market instruments are down, mostly 25 to 40 basis points, bond yields are unchanged to up a little. Uncertainty about the Federal Reserve's intentions, together with the weakness of the dollar and cautious readings of the incoming economic and price news, contributed to the relative softness of longer-term markets and the steeper yield curve which emerged during the period.

Growth in M2 and M3 picked up to around a 13 percent annual rate in July, noticeably faster than in June and the second-quarter average. Apart from the strength in M1, most of the pickup in M2 growth was accounted for by heavy issuance of overnight RPs at commercial banks, which made large purchases of Treasury securities during the month. The balance of M2 growth was mostly in MMDAs and money market mutual funds, owing to lagged adjustment of their rates to declines in money market rates, while small time deposits extended the runoff which commenced during the second quarter. M3 growth in July--which was about double the June pace--was generated in part by an upturn in large time deposits at thrift institutions, acting to raise their liability bases in light of possible restrictions on balance sheet expansion. Institution-only money market funds likewise recorded very strong growth during July. Both M2 and M3 are currently in the upper portions of their 1986 target ranges.

Domestic nonfinancial debt growth appears to be a little higher in the current quarter, despite a drop-back in Federal borrowing on a seasonally adjusted basis after a very strong second quarter. On a not seasonally adjusted basis the combined federal deficit for the third calendar quarter of $58 billion (n.s.a.) is about twice the size of the second-quarter deficit, and the Treasury is expected to borrow about $48 billion through sale of marketable obligations, financing the remainder by drawdowns in cash balances and sales of nonmarketable securities.

Having reached the current federal debt ceiling, the Treasury has used the borrowing capacity of the Federal Financing Bank to supplement its financing for August. Without legislative action, Treasury resources appear sufficient to maintain operations only until early September, but the Congress is expected to pass a temporary increase in the debt ceiling before its Labor Day recess.

Business debt growth has slowed in the past couple of months. Business loans at commercial banks were flat in July and the average amount of commercial paper outstanding fell sharply. After a substantial pickup earlier in the year, gross public offerings of corporate bonds tapered off in July and early August in response to higher long-term interest rates. The share of public bond offerings with maturities of 20 years or greater has diminished, but new issues of low-rated bonds have remained substantial. Corporate borrowing demands have continued to be greatly affected by merger and acquisition activity, as the financing gap between internal funds and capital outlays evidently has remained at a low level.

Gross issuance in tax-exempt bond markets picked up in July and early August to around a $20 billion monthly pace, as borrowers sought to beat the revised deadlines on tax-reform proposals being considered by Congress. Tax-exempt rates remain high relative to yields on taxable obligations, owing to concerns about income tax reform, but they nonetheless are attractive to many governmental units with old, high-coupon debt to refund. Unlike in late 1985--the only time when offerings exceeded the recent rate--the bulk of tax-exempt securities coming to market now are public-purpose rather than private-purpose issues. In fact, some authorities are turning to taxable markets to finance private-purpose projects.

In the household area, home mortgage debt expanded at an 11-3/4 percent annual rate during the second quarter, a snapback from the surprisingly low first-quarter pace. However, growth in net mortgage debt still appears to be somewhat constrained by processing backlogs caused by heavy refinancing activity. New home mortgage loans are now predominantly in fixed-rate form; the share of ARMs has sunk to less than one-fourth of total conventional loans. Mortgage pool activity remains vigorous, and in June and July alone gross issuance of federally sponsored pass-throughs came to about one-half of last year's total.

Growth in consumer installment credit slowed to around 11 percent in June, somewhat lower than the first-half average and distinctly below last year's experience. Commercial bank data suggest no pickup in July. GMAC and other lenders have continued to issue sizable amounts of pass-through securities based on automobile receivables, and about $3.7 billion in such securities may now be outstanding. Delinquency rates on finance company auto loans fell a little in the second quarter.

Outlook. Aggregate credit demands are not expected to change much over the balance of 1986, so that nonfinancial sector debt expansion is likely to remain above the upper end of the 1986 monitoring range. Federal borrowing will be substantial on the whole, with the time pattern possibly affected by congressional action on the debt ceiling. Congressional action on tax reform also is potentially a major factor in tax-exempt market activity. The staff is projecting a drop-off in tax-exempt bond issuance after the current quarter, with a sharp decline in public-purpose financings likely more than offsetting the pickup in private-purpose offerings that is likely once tax-reform uncertainties are eliminated.

In business finance, the near-term outlook is for a small and almost unchanged corporate financing gap (of around $15 billion) in the third quarter, followed by a gradual widening thereafter. Internal funds of corporations likely will be reduced by the effects of tax reform, but expenditures for inventories and fixed capital are expected to be sluggish. Still, merger and restructuring activity is continuing to run strong, and net equity issuance will remain deeply negative even if gross share issuance is well maintained. On balance, business debt is expected to grow only somewhat less rapidly than in the first half, with corporate borrowing concentrated in the bond markets.

Home mortgage debt growth over the balance of the year likely will pick up further in coming months, as refinancing backlogs at lenders are cleared away. Consumer credit growth in the second half of 1986 is projected to continue the perceptible slowdown that characterized the first half of the year.

Recent developments. Since the last FOMC meeting, the weighted-average foreign exchange value of the dollar has declined nearly 3 percent on balance. The dollar depreciated 4-3/4 percent against the mark, fell somewhat less against the yen, but appreciated 3 percent against sterling. The Federal Reserve's unilateral reduction in the discount rate on July 10 contributed to the view by market participants that U.S. authorities were willing to accept a lower dollar in order to counter somewhat lackluster economic activity shown in recent U.S. data. Further declines in oil prices and waning political support for the British government prompted selling pressure on the pound.

Short-term interest rates abroad were little changed during the intermeeting period while comparable U.S. rates declined by about one-third of a percentage point. The differential between U.S. and German and Japanese long-term interest rates on balance was about unchanged.

Data for the first half of the year in the major foreign industrial countries continue to indicate generally weak real activity and further slowing of inflation. On average in the second quarter, industrial production in both Germany and Japan was about equal to or only slightly above averages at the end of last year. In recent months consumer prices have declined in Japan, Germany, and the United Kingdom, and the rate of inflation has slowed to levels that are very low by recent historical standards in all of the major foreign industrial countries. Japan and Germany continue to experience record nominal trade surpluses although measures of trade volume show declines in exports and increases in imports. Both the United Kingdom and Canada have experienced deteriorating trade balances in recent months.

In July, Mexican officials signed a letter of intent in support of an 18-month stand-by arrangement with the IMF for SDR 1.4 billion. The government of Brazil announced a number of measures designed to restrain domestic demand and to encourage the holding of longer-term securities. Venezuela's Congress approved legislation establishing an Exchange Compensation Fund (FOCOCAM) to coordinate rescheduling of registered private sector external debt to foreign commercial banks, but the banks have objected strongly to the terms of the legislation. In response, the government reportedly will propose liquidation of FOCOCAM to the Congress, but it is unclear what, if anything, the government will put in its place.

Staff estimates for U.S. merchandise trade data, adjusted to a balance-of-payments basis, show a trade deficit in the second quarter about unchanged from its first-quarter value. While agricultural exports and most categories of non-agricultural exports declined, a substantial increase in exports of gold offset these decreases and resulted in a value of total exports equal to the first-quarter figure. The gold exports were largely to Japan to be used in the minting of a commemorative coin; the gold had been imported into the United States over the past six months. Tentative estimates for the second quarter show a decline in oil imports that appears to have been roughly offset by higher non-oil imports. About one-half of the increase in the value of non-oil imports appears to result from rising import prices.

Foreign official reserve assets in the United States increased sharply in the second quarter, primarily as a result of large scale foreign exchange market intervention by G-10 authorities. In contrast, net private foreign purchases of U.S. Treasury securities were relatively small in the second quarter. Net private foreign purchases of both U.S. corporate stocks and bonds, $23 billion in the second quarter as a whole, continued at very high levels experienced recently, but acquisitions of both stocks and bonds were substantially lower in June than earlier in the quarter.

Outlook. The staff continues to project a moderate decline in the value of the dollar through the end of 1987. The OPEC decision to limit oil production temporarily in September and October is consistent with the staff expectation that the average price of U.S. oil imports will rise from current low level of $11 per barrel estimated for the third quarter of 1986 to $16 per barrel by the first quarter of 1987. The pace of economic growth abroad is projected to remain only moderate. The staff outlook for the U.S. current account balance is little changed from that previously presented. The U.S. current account deficit is expected to average $135 billion this year and is not expected to begin to narrow until 1987. By the fourth quarter of 1987, the deficit is projected to decline to approximately $125 billion (s.a.a.r.). Higher projected prices for U.S. non-oil imports boost the value of imports over the forecast horizon. As a result, the improvement in the nominal external deficit is expected to be much less than the improvement in real net exports as recorded in the GNP accounts.

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Outlook for U.S. Net Exports and Related Items
(Billions of Dollars, Seasonally Adjusted Annual Rates)

	ANNUAL			1985		1986				1987			
	1985-	1986-P	1987-P	Q3-	Q4-	Q1-	Q2-	Q3-P	Q4-P	Q1-P	Q2-P	Q3-P	Q4-P
1. GNP Exports and Imports 1/													
Current $, Net	-78.9	-93.5	-88.3	-83.7	-105.3	-93.7	-96.6	-89.0	-94.7	-95.2	-92.2	-86.1	-79.7
Exports of G+S	369.7	383.1	437.8	362.3	368.2	374.8	375.6	384.7	397.3	412.0	427.1	446.5	465.7
Imports of G+S	448.6	476.6	526.1	446.0	473.6	468.5	472.2	473.7	492.0	507.2	519.2	532.6	545.4
Constant 82 $, Net	-108.2	-134.8	-100.2	-113.8	-132.0	-125.9	-146.5	-138.3	-128.7	-117.1	-106.3	-94.5	-82.8
Exports of G+S	362.3	378.7	424.1	355.8	362.9	369.2	371.9	381.0	392.8	404.0	415.7	431.0	445.6
Imports of G+S	470.5	513.6	524.3	469.6	494.8	495.1	518.5	519.3	521.6	521.2	522.1	525.5	528.5
2. U.S. Merchandise Trade Balance 2/	-124.4	-143.6	-139.1	-126.7	-149.4	-146.3	-145.1 P	-139.9	-143.0	-146.1	-141.7	-137.2	-131.5
Exports	214.4	216.2	250.7	210.0	210.9	214.2	213.9 P	214.1	222.8	231.9	243.8	256.7	270.5
Agricultural	29.6	25.3	27.2	26.7	28.5	28.4	25.0 P	23.3	24.5	26.1	26.9	27.4	28.4
Non-Agricultural	184.8	191.0	223.5	183.3	182.4	185.8	188.9 P	190.8	198.3	205.8	217.0	229.3	242.1
Imports	338.9	359.8	389.9	336.7	360.3	360.5	359.0 P	354.0	365.8	378.0	385.6	393.9	402.0
Petroleum and Products	50.5	32.5	38.5	49.5	56.5	40.1	31.0 P	25.7	33.1	37.7	37.7	38.8	39.9
Non-Petroleum	288.3	327.4	351.3	287.2	303.8	320.5	328.0 P	328.3	332.7	340.2	347.9	355.1	362.1
3. U.S. Current Account Balance	-117.7	-136.1	-135.0	-113.8	-134.8	-134.7	-137.4 P	-131.4	-141.0	-140.6	-138.8	-133.2	-127.3
Of Which: Net Investment Income	25.2	22.4	16.5	33.0	37.0	27.3	22.4 P	21.3	18.7	17.3	15.6	16.5	16.6
4. Foreign Outlook 3/													
Real GNP--Ten Industrial 4/	2.8	2.5	3.1	3.0	2.6	0.1	3.5 P	3.5	3.6	3.0	2.8	2.7	2.6
Real GNP--NonOPEC LDC 5/	3.4	3.1	4.1	2.9	2.9	3.0	3.2 P	3.5	3.8	4.1	4.4	4.7	4.9
Consumer Prices--Ten Ind. 4/	4.3	2.2	2.6	1.4	3.1	1.7	1.7 P	1.8	2.4	2.8	3.0	2.8	2.9

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