STRICTLY CONFIDENTIAL (FR) CLASS II–FOMC

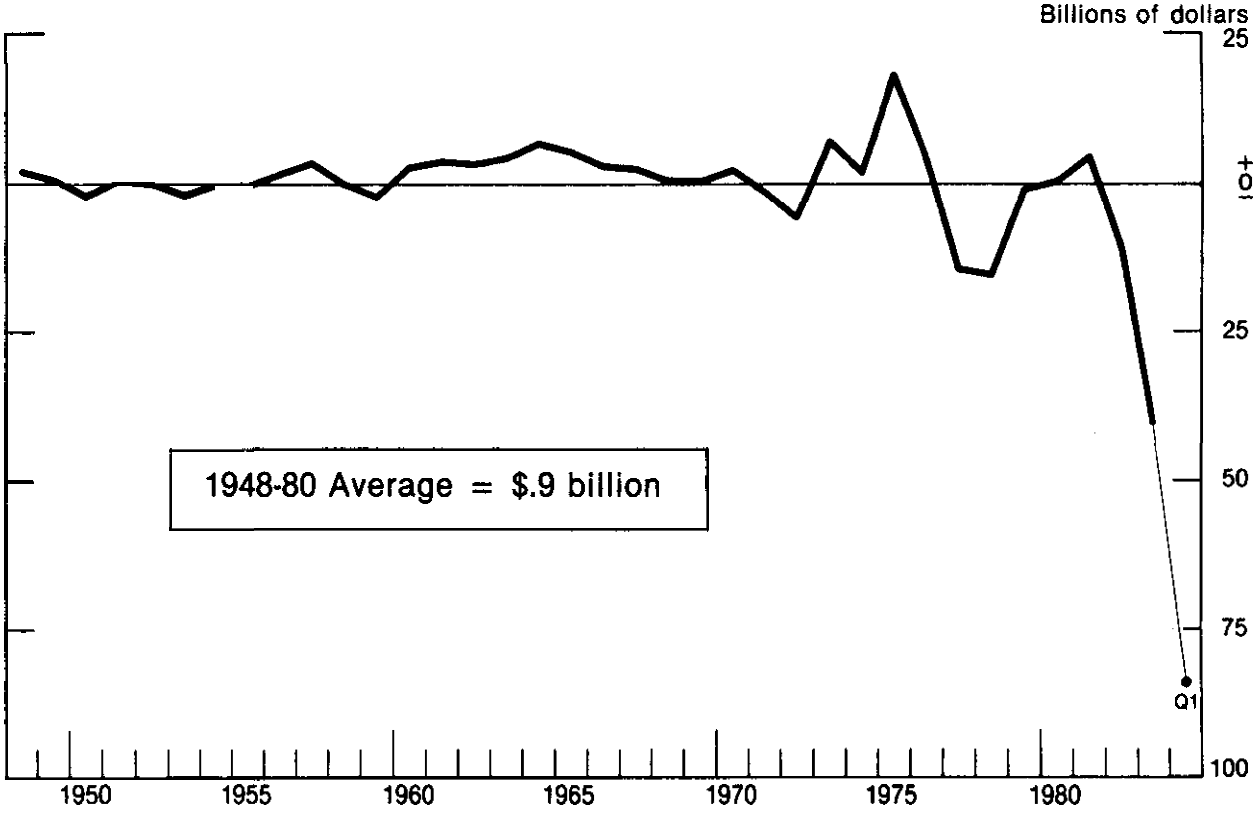
Materials for Staff Presentation to the Federal Open Market Committee

The U.S. External Position

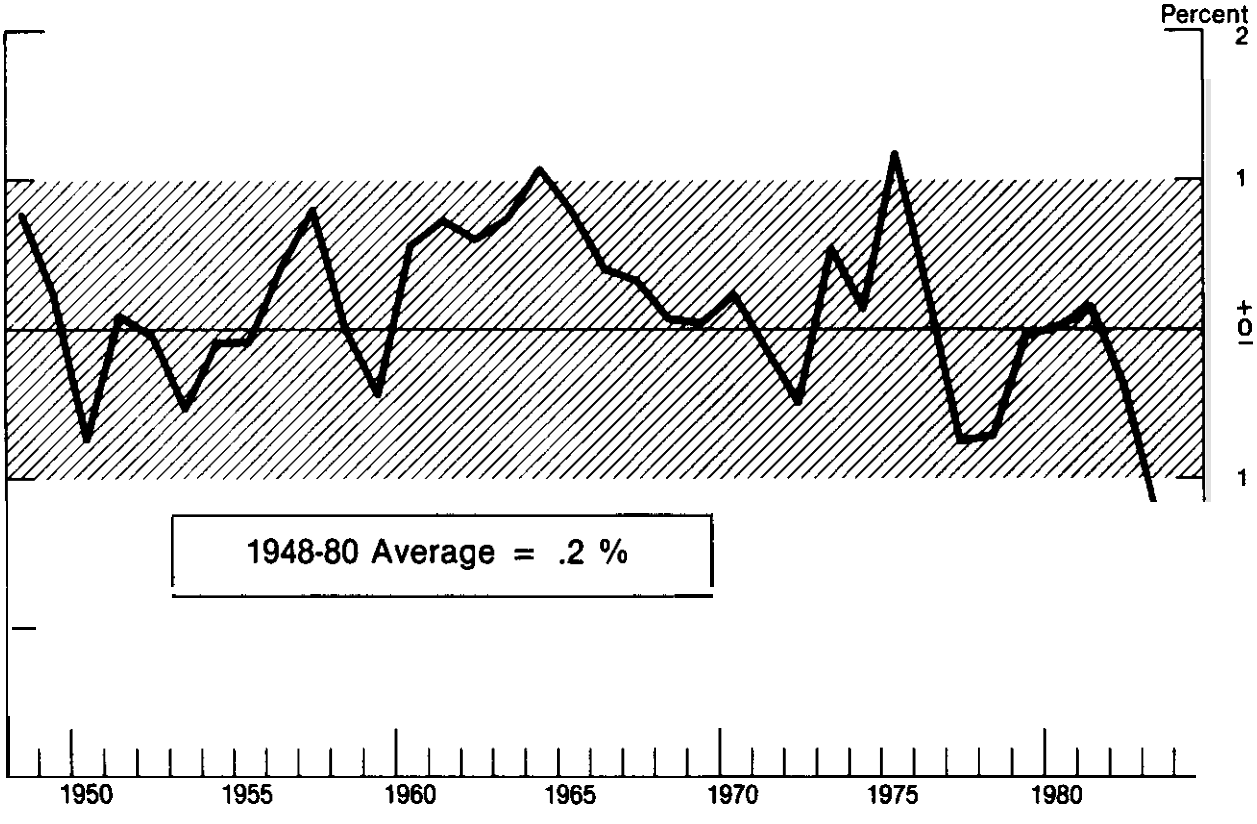
May 21, 1984

Chart 1

U.S. Current Account



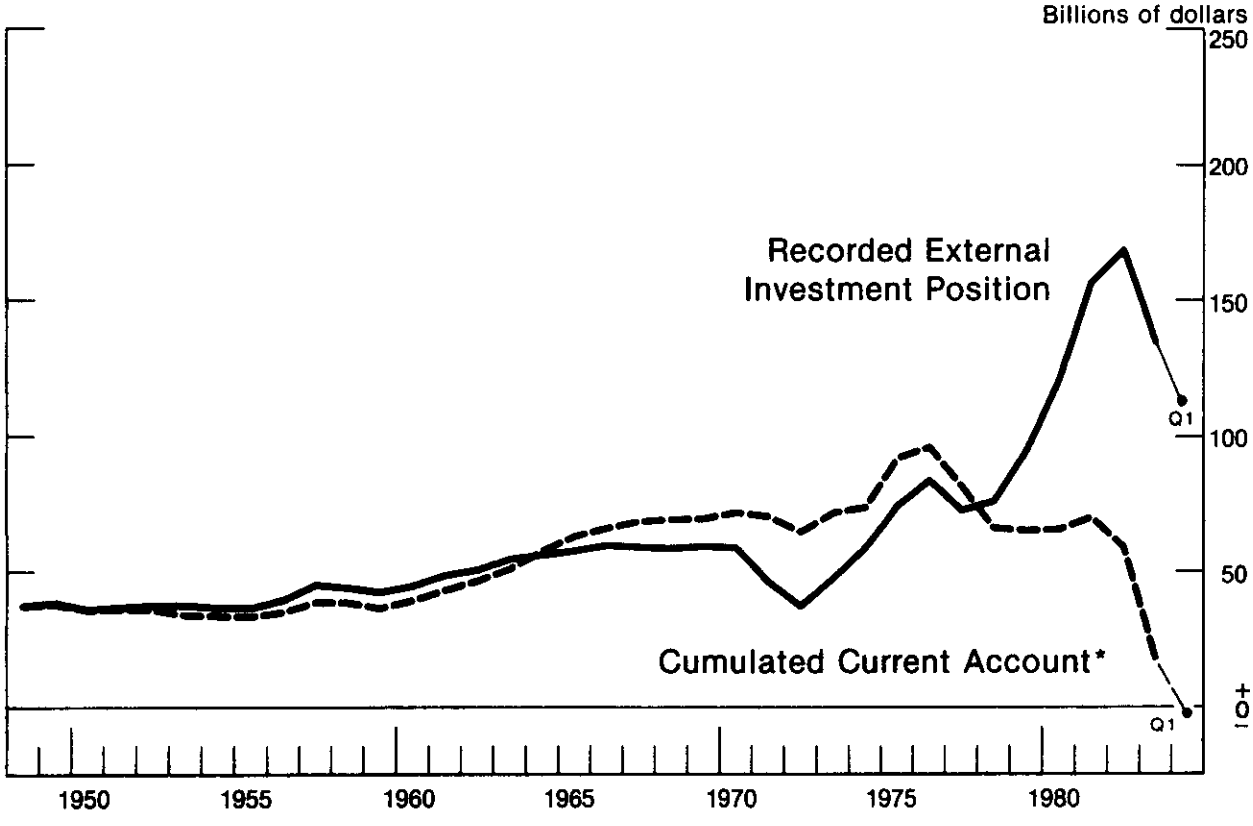
U.S. Current Account Relative to GNP



Note: 1984 data are Q1 estimates at an annual rate

Chart 2

U.S. External Investment Position



*From base of 1948 recorded external investment position.

Note: 1984 data are Q1 estimates.

Chart 3

ANALYTICAL FRAMEWORK

I Proximate Determinants

- Price competitiveness
- Relative cyclical positions
- Other factors

  International debt problems

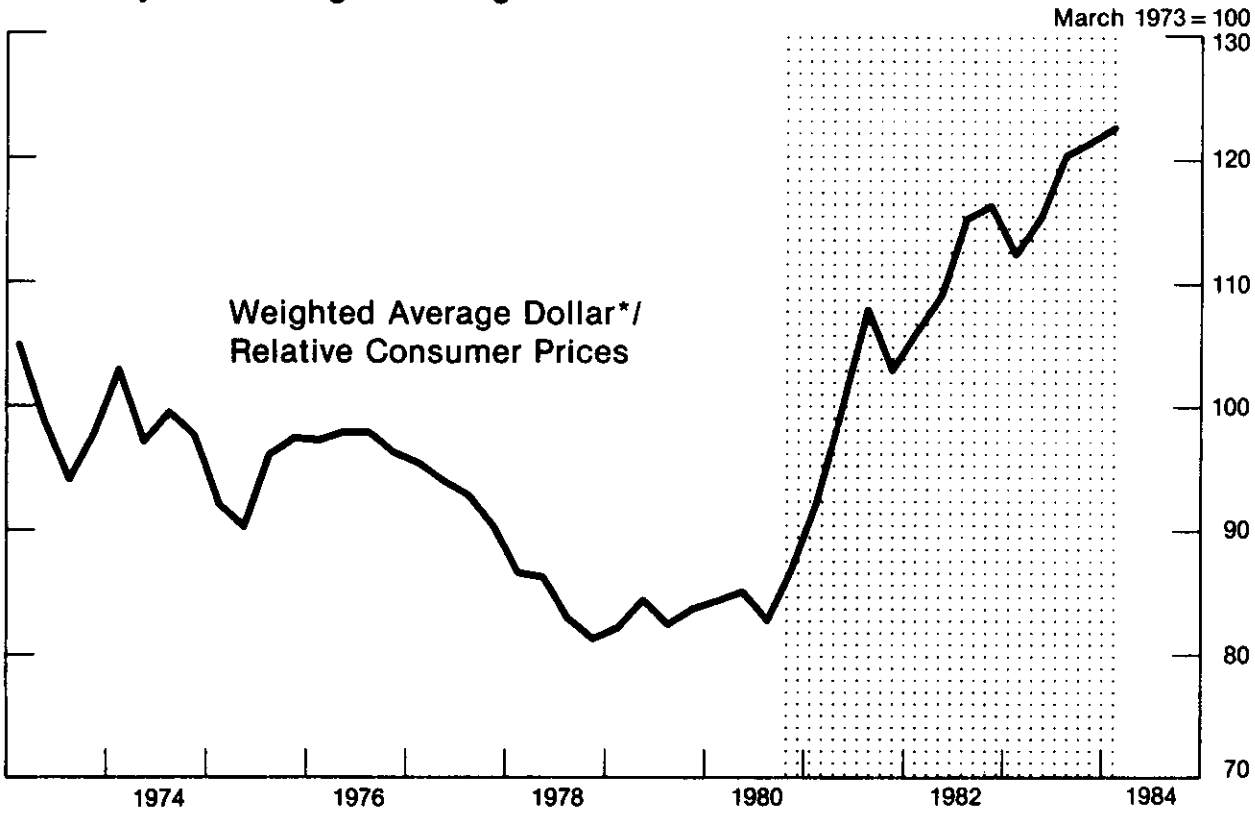
  Oil

II Fundamental Determinants

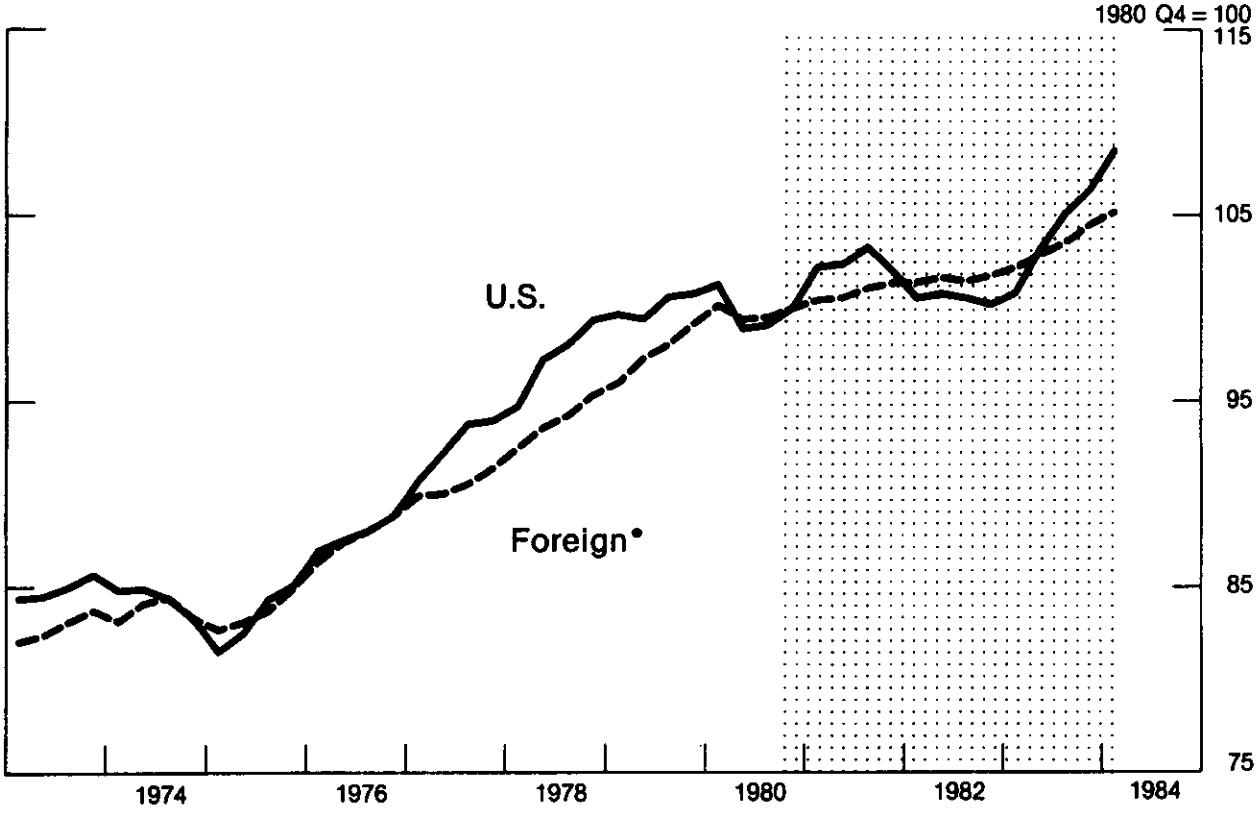
- Economic policies
- Asset preferences

Chart 4

Price Adjusted Foreign Exchange Value of the U.S. Dollar



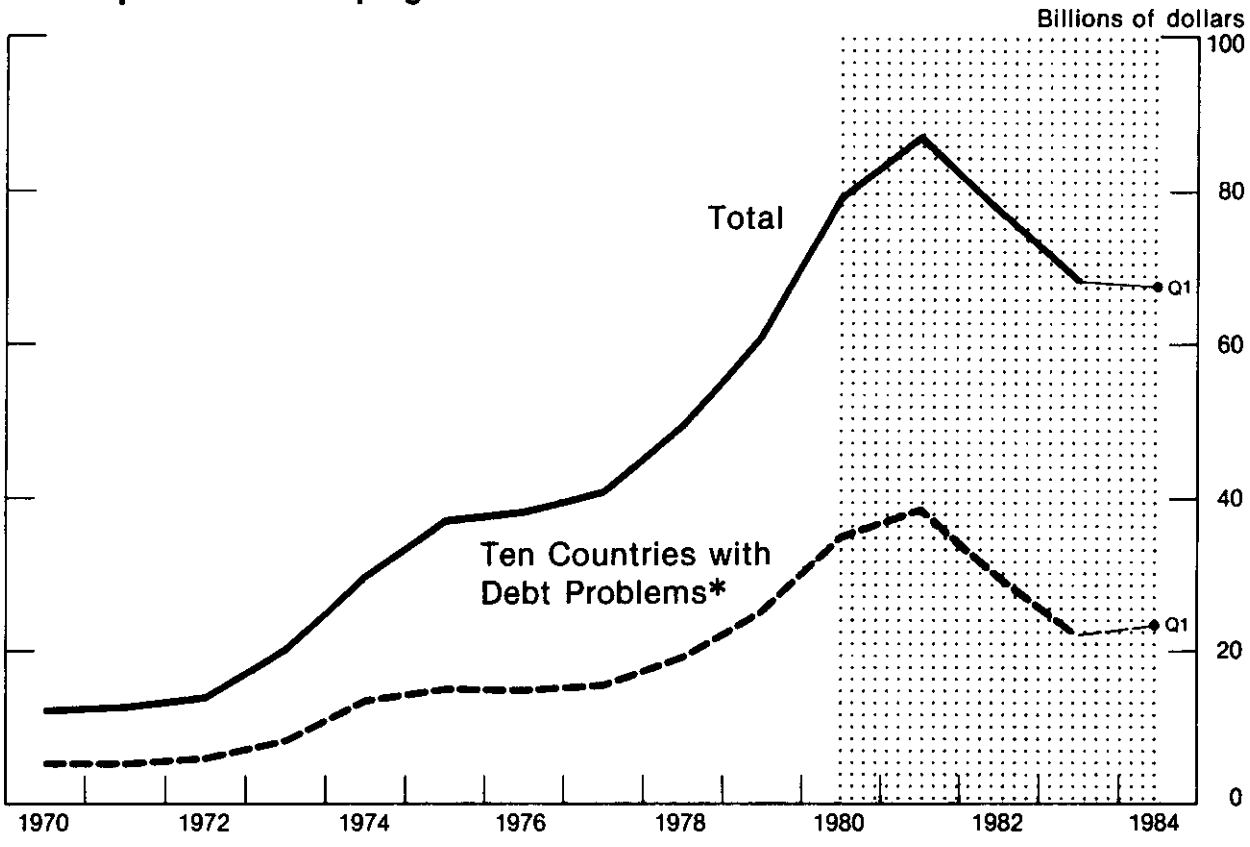
Real GNP



*Weighted average against or of foreign G-10 countries using total 1972-76 average trade of these countries.

Chart 5

U.S. Exports to Developing Countries



*Includes Argentina, Brazil, Chile, Colombia, Ecuador, Mexico, Nigeria, Peru, Philippines and Venezuela.
Note: 1984 data are Q1 estimates at an annual rate.

Chart 6

Allocation of Decline in Current Account Among Proximate Determinants

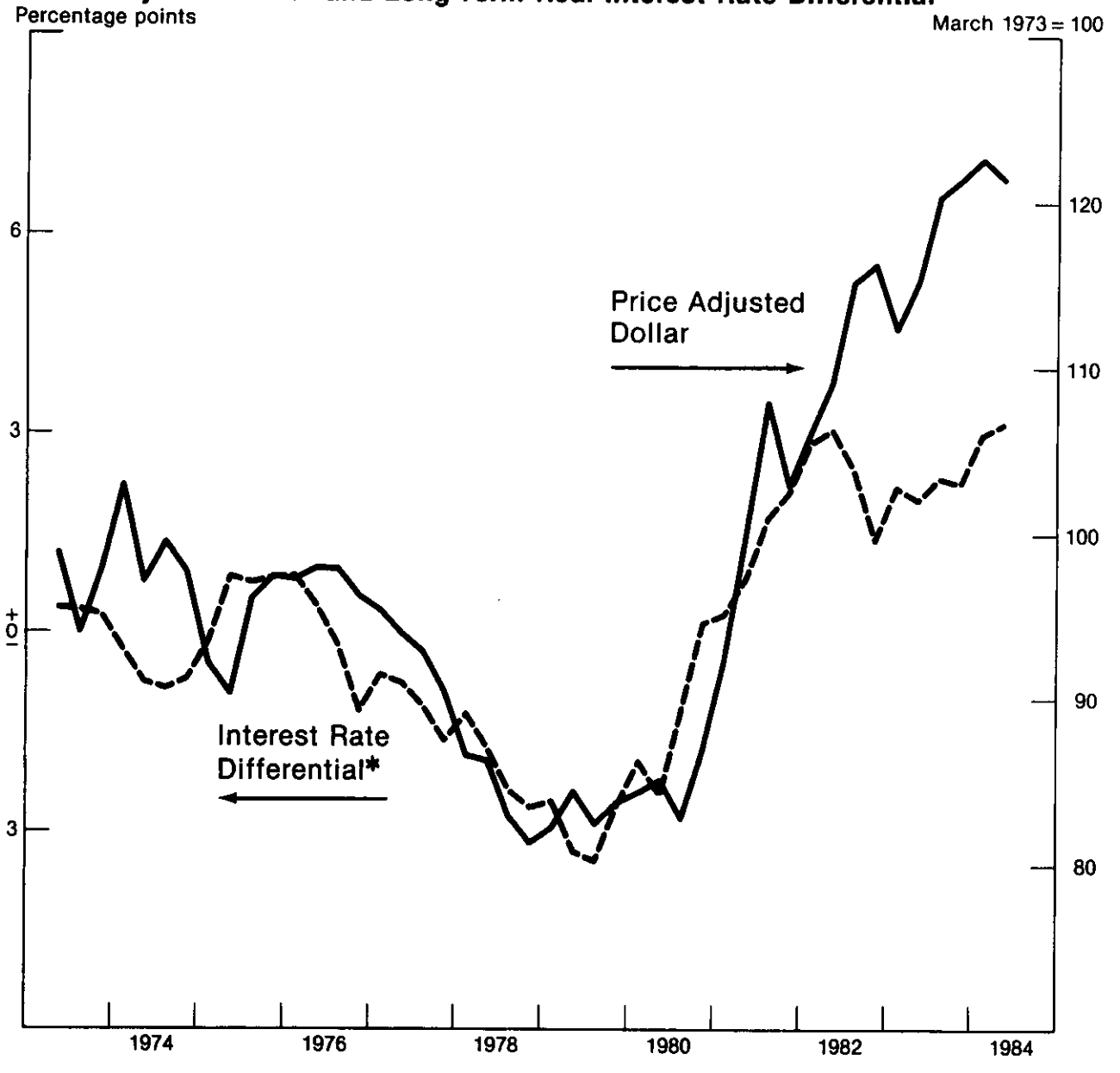
	Billions of dollars
1. Decline in Current Account, 1980 to 1984 Q1	**−85**
2. Decline in U.S. Price Competitiveness	−70
3. Cyclical - Relative Strength of U.S. Recovery	−20
4. International Debt Problems	−15
5. Decline in Oil Prices and Consumption	+20

Estimated Impacts of Increase in Structural Budget Deficit

	Calendar Years		
	1982	1983	1984
1. Increase in Structural Deficit from 1981 Level ($ billions)	35	66	102
Impact on Levels of:			
2. Real GNP (percent)	1¼	2½	2½
3. Treasury Bill Rate (percentage points)	¾	2	2½
4. Exchange Rate (percent)	3	6	8
5. Prices (percent)	0	0	¼
6. Current Account Balance ($ billions)	−8	−17	−30

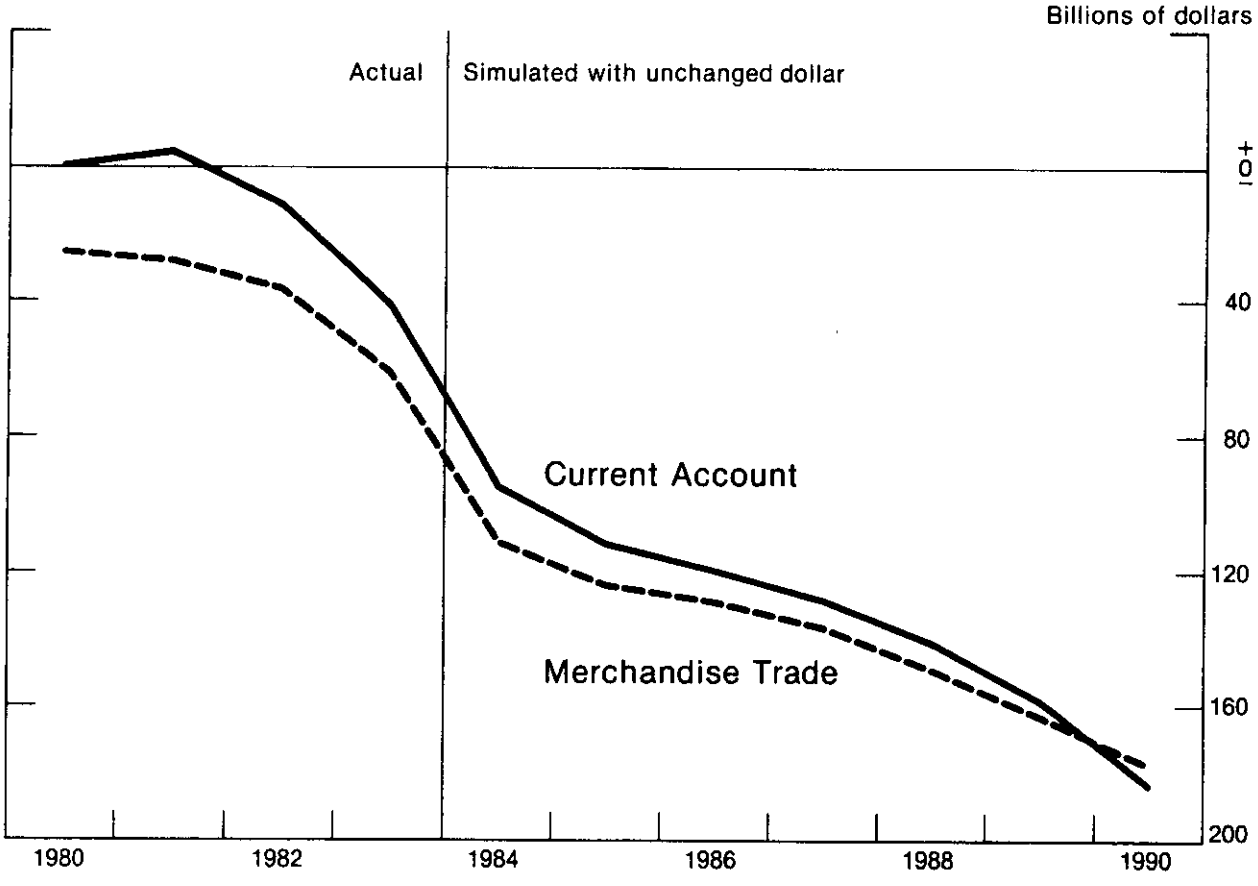
Chart 8

Price Adjusted Dollar and Long-Term Real Interest Rate Differential



* Differential between U.S. and weighted average foreign long-term government bond yields minus differential between 12-quarter centered moving averages of U.S. and foreign consumer price inflation rates.

U.S. Merchandise Trade and Current Account Balances



Explanatory Variables Simulated With Unchanged Dollar

	1984	1985	Annual Average 1986–1990
1. Exchange Rate Index	130	130	**130**
		Percent change, Q4/Q4	
Real GNP Growth Rates			
2. United States	5	2½	**3**
3. G-10 Countries	2¾	3	**3½**
4. Developing Countries	3½	4½	**5**
Inflation Rates*			
5. United States	5	5¼	**5**
6. G-10 Countries	5¾	6½	**6¾**

* Based on consumer price indexes.

Chart 10

Current Account Components Simulated with Unchanged Dollar

	Billions of dollars		
	1983	1990	**Change**
1. Current Account	– 41	– 183	**– 142**
2. Merchandise Trade	– 61	– 177	**– 116**
3. Net Investment Income	24	– 17	**– 41**
4. Portfolio	9	– 53	**– 62**
5. Direct	15	36	**21**
6. Other Services and Transfers	– 4	11	**15**

Chart 11

Volume of Merchandise Exports and Imports

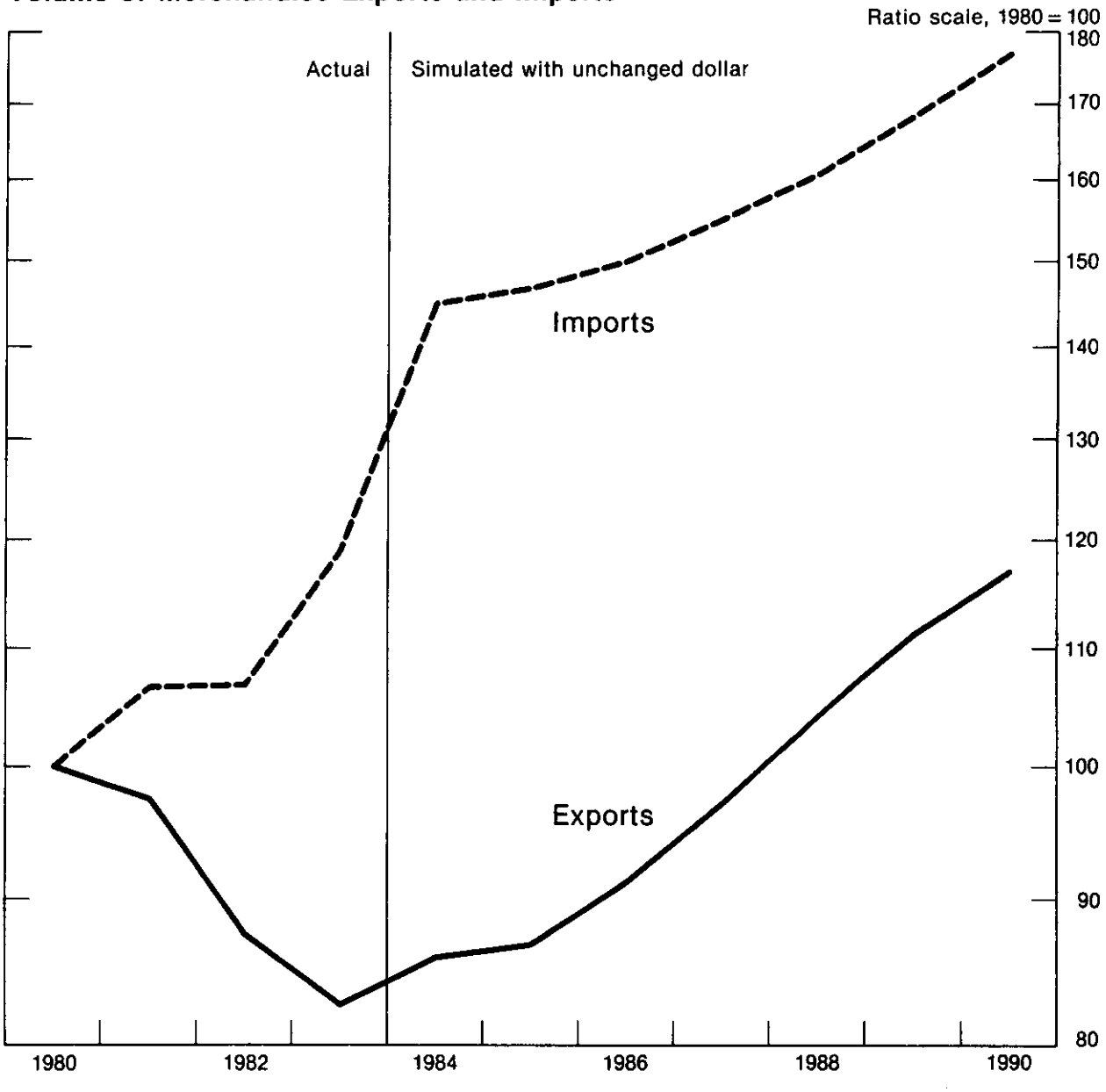
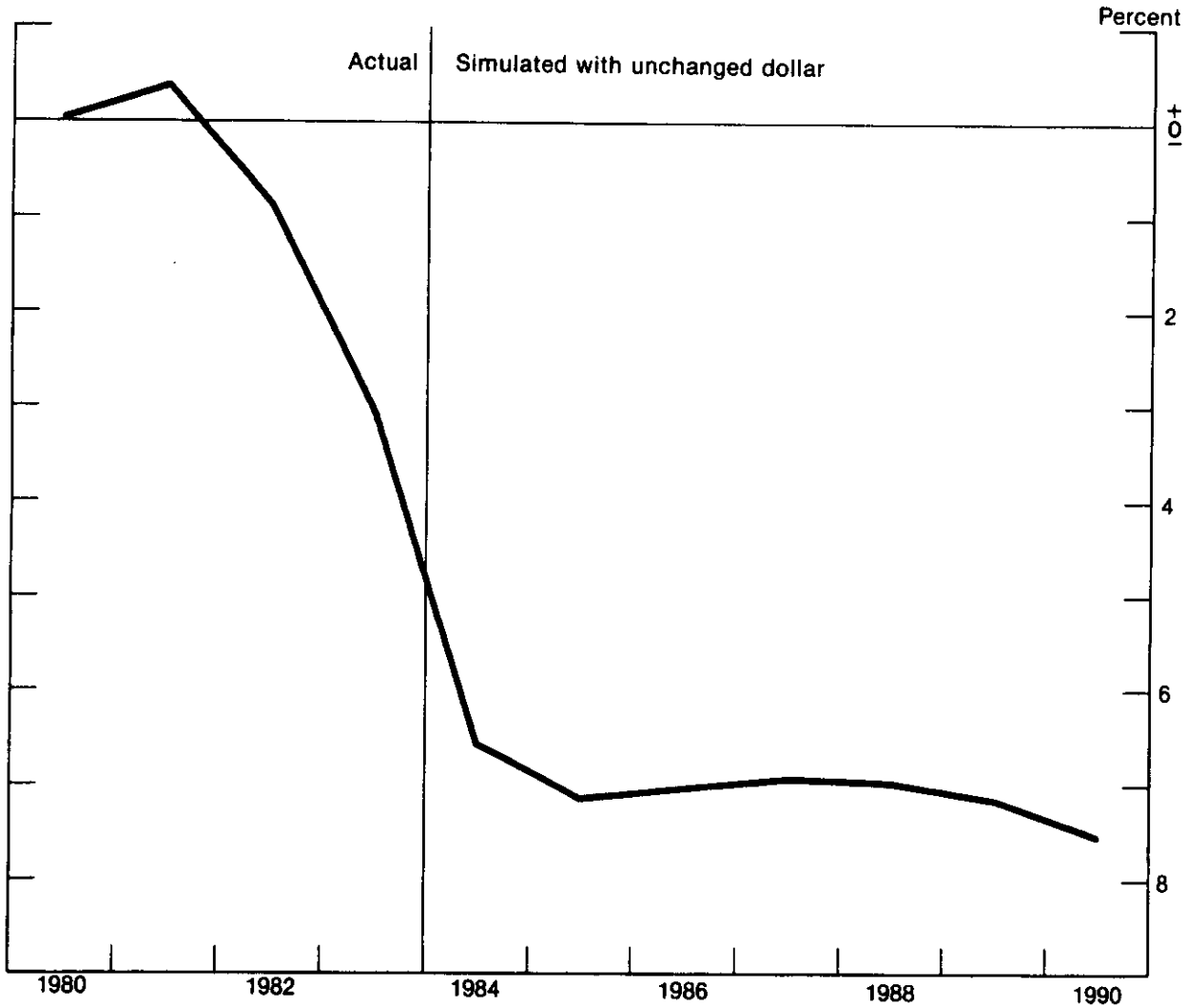
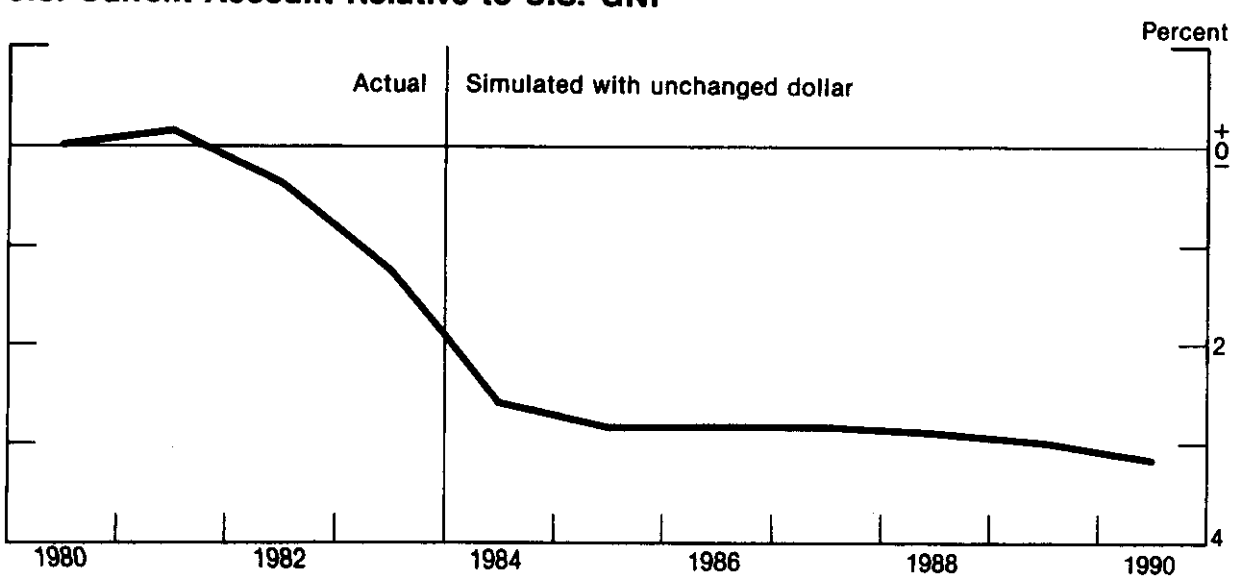


Chart 12

U.S. Current Account Relative to Foreign Net Saving*

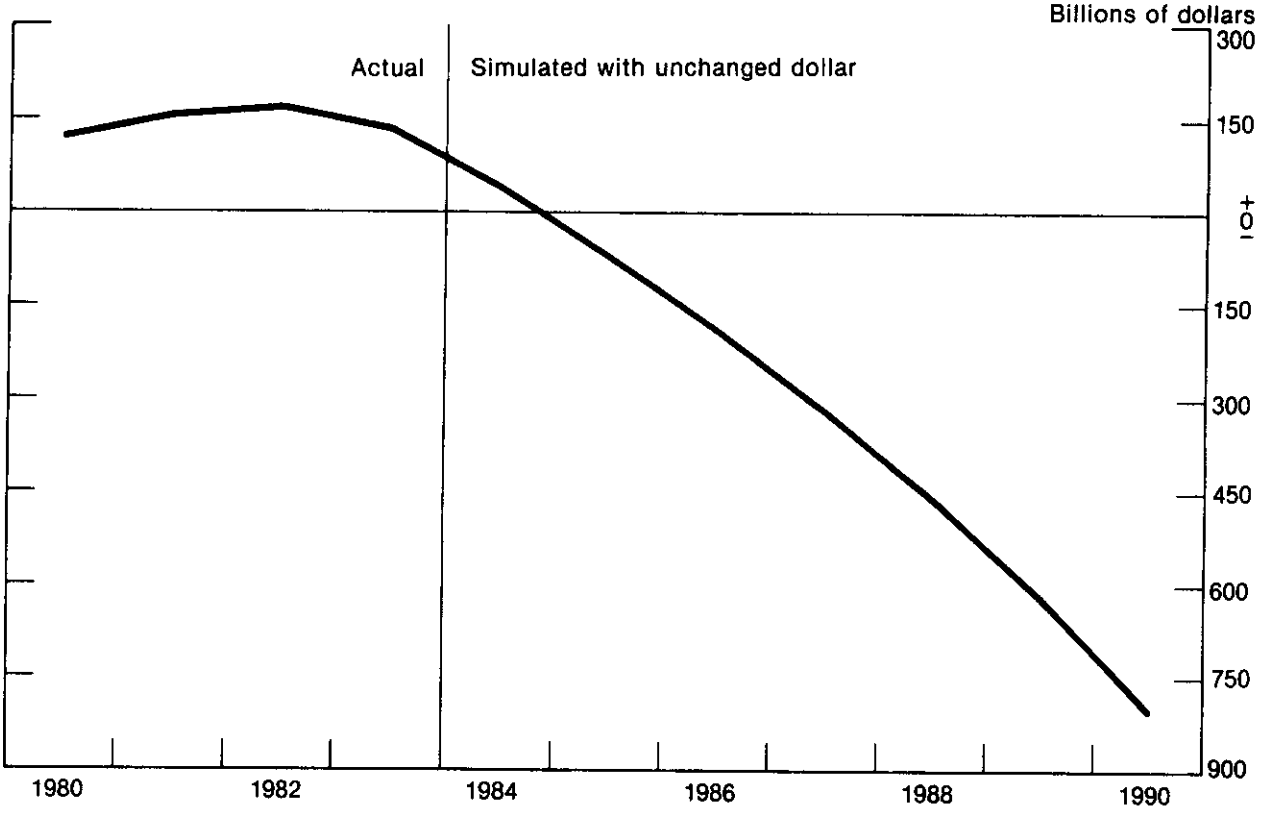


U.S. Current Account Relative to U.S. GNP

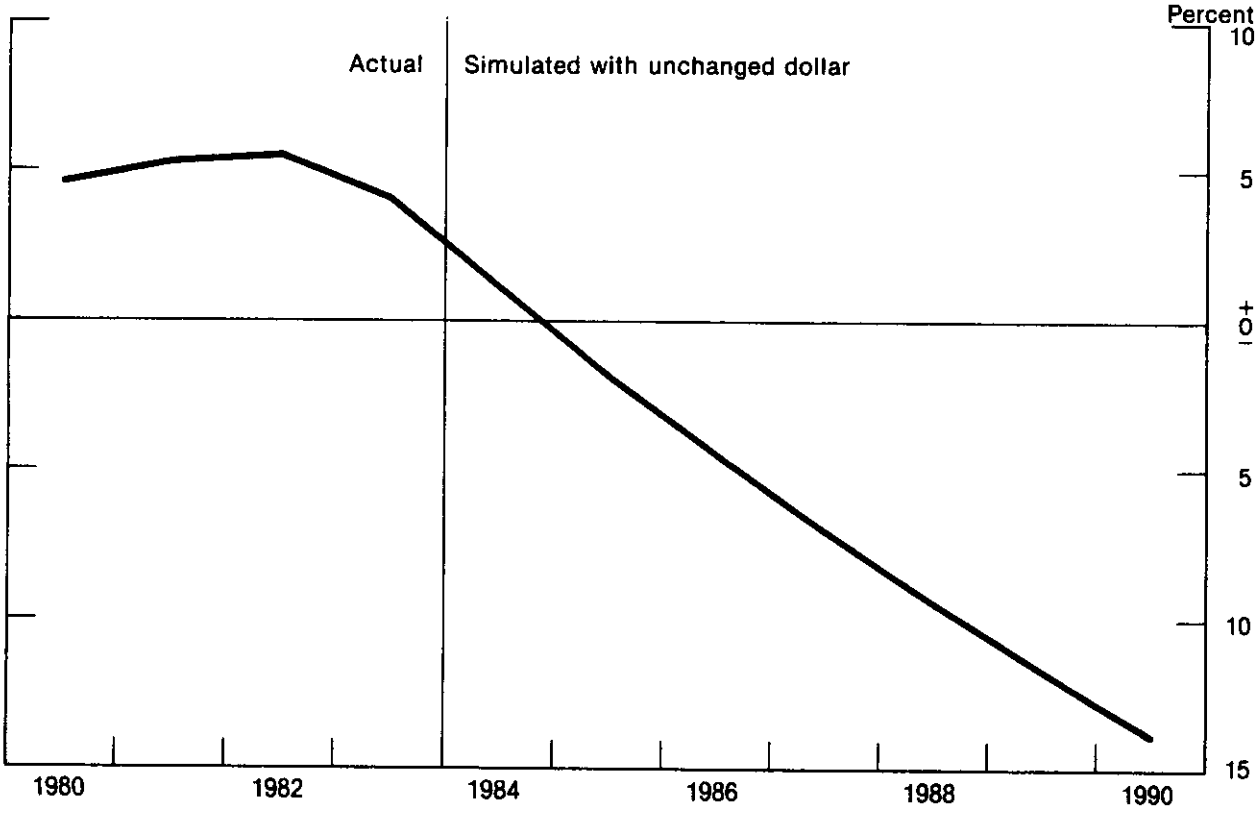


*Estimated gross saving less capital consumption.

U.S. External Investment Position



U.S. External Investment Position Relative to GNP



SUSTAINABILITY

- External investment position relative to GNP must stabilize.

DESIRABILITY

- Short run benefits
  - Current account deficit reduces upward pressure on domestic interest rates.
  - Growth of U.S. imports has expansionary effects on economic activity abroad and eases current account adjustment in countries burdened with debt.
- Long run questions
  - To what extent is borrowing from abroad leading to greater capital formation in the United States?
  - Is borrowing by the United States consistent with an efficient and equitable allocation of world saving?

Chart 15

Foreign Exchange Value of the U.S. Dollar

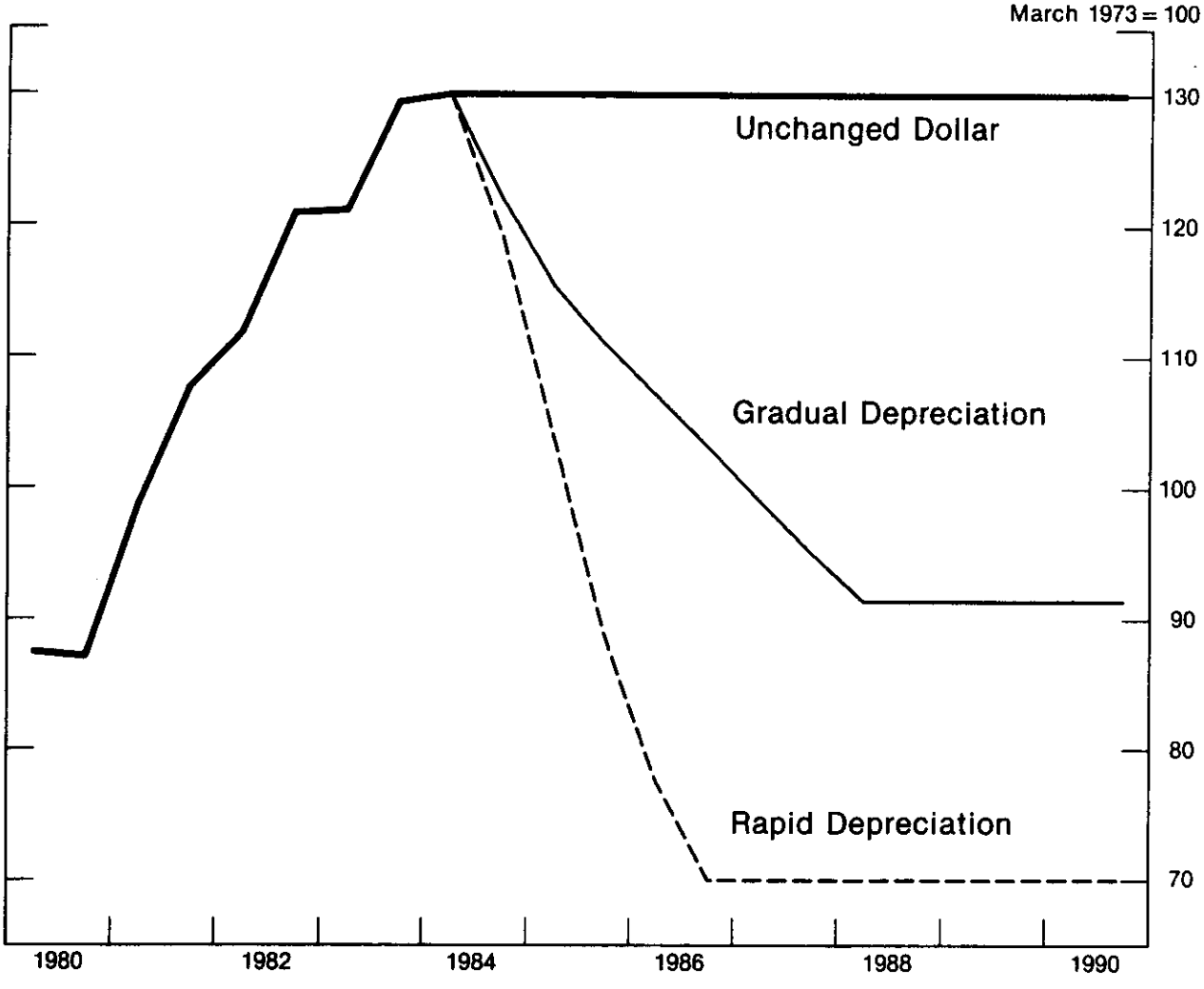
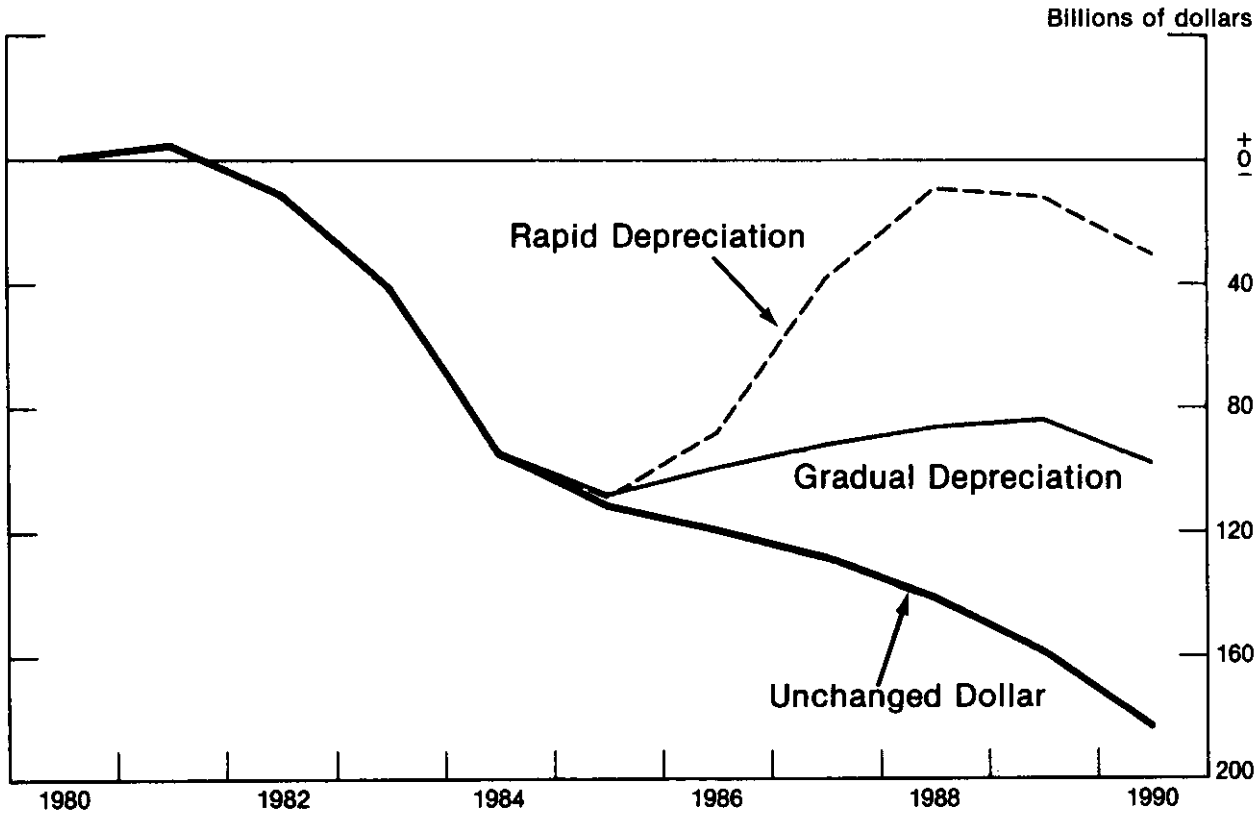


Chart 16

Effects on U.S. External Position

Current Account



External Investment Position Relative to GNP

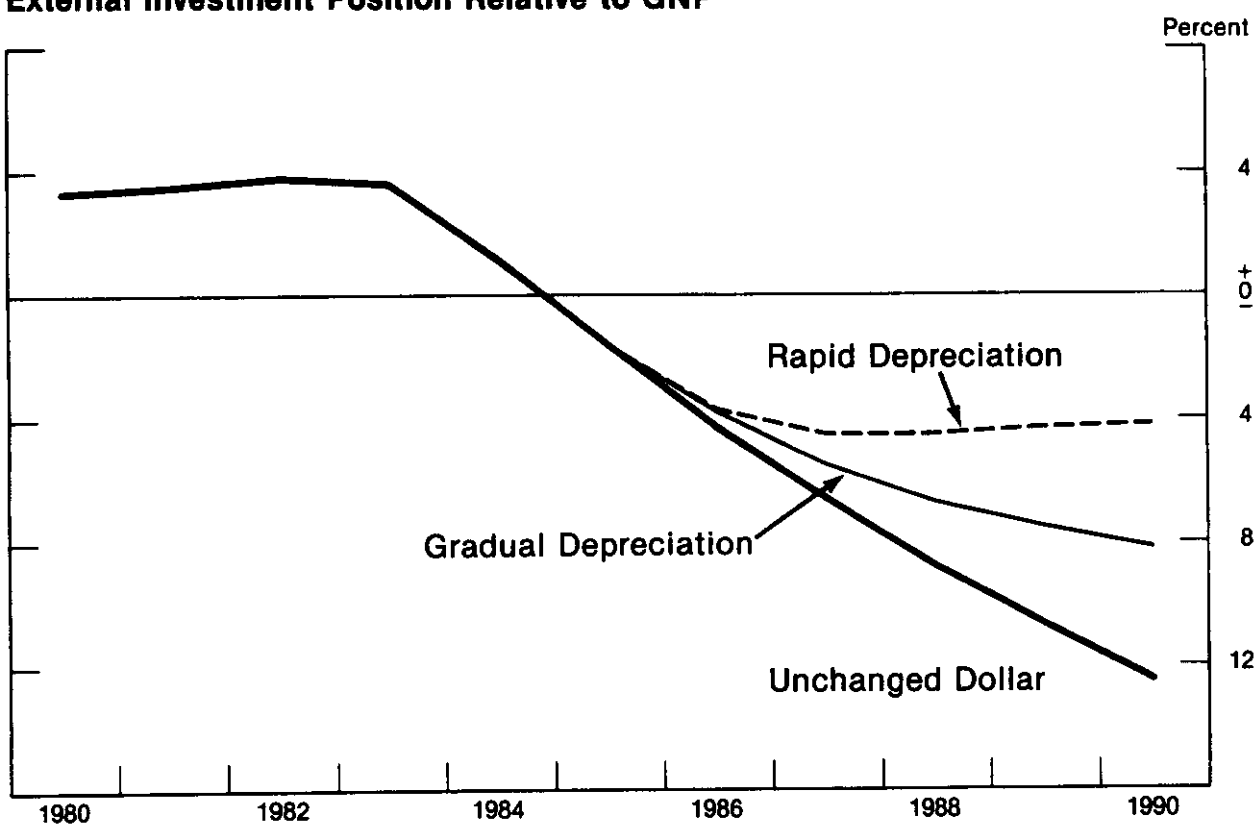
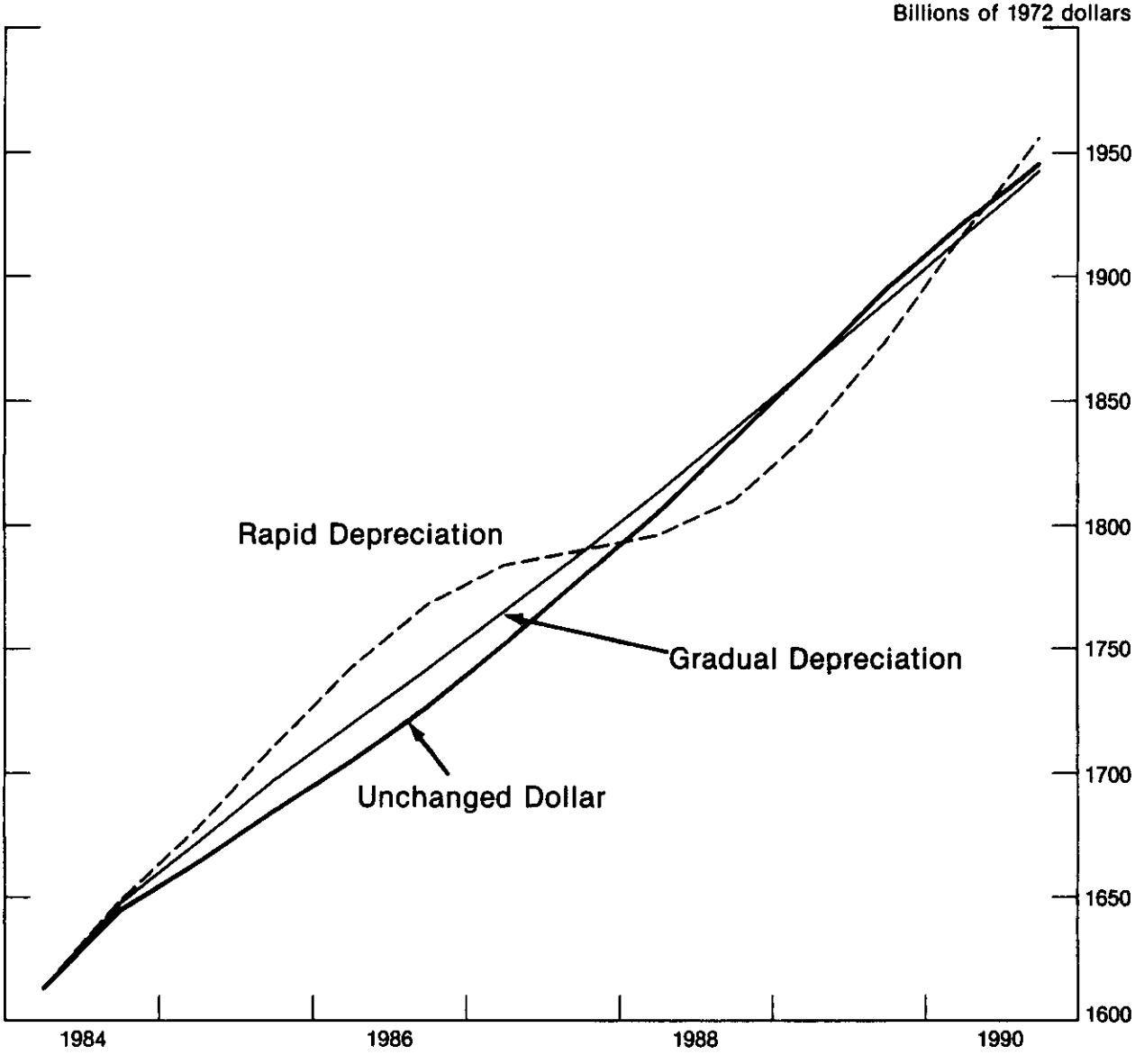


Chart 17

Effects on U.S. Economy

Real GNP



Inflation

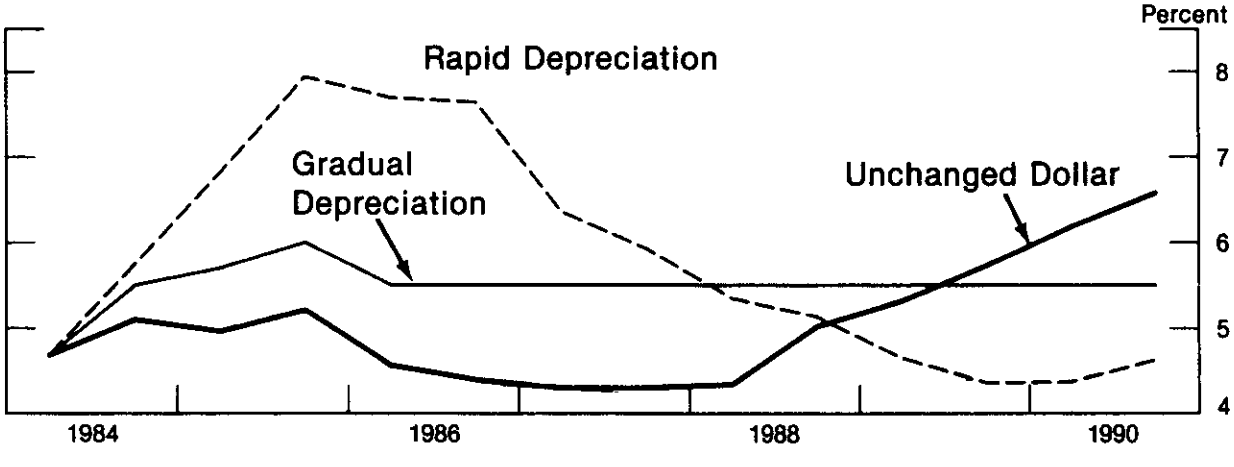


Chart 18

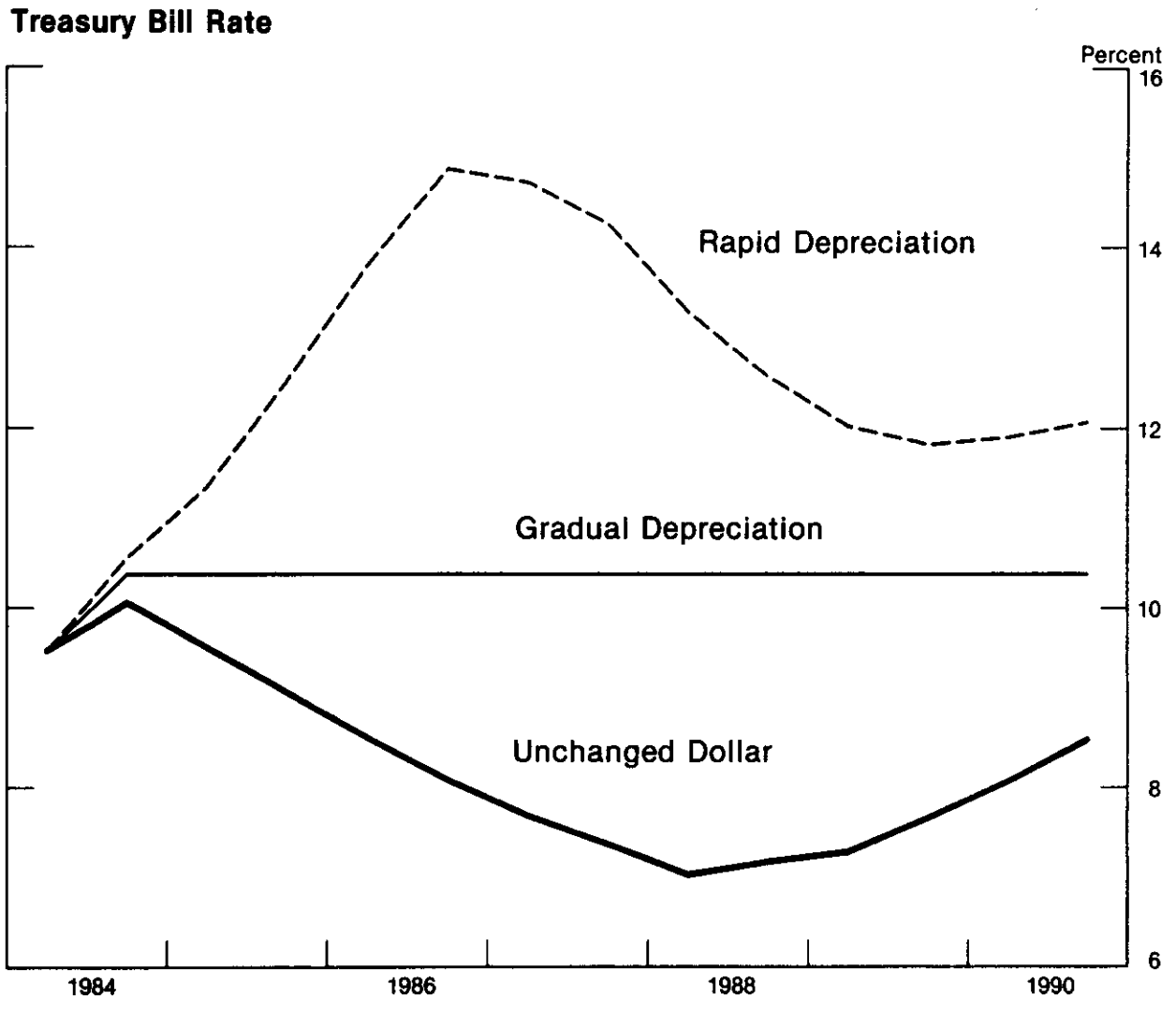

Treasury Bill Rate
Percent
16
14
12
10
8
6
Rapid Depreciation
Gradual Depreciation
Unchanged Dollar
1984
1986
1988
1990

Chart 19

Foreign Exchange Value of the U.S. Dollar

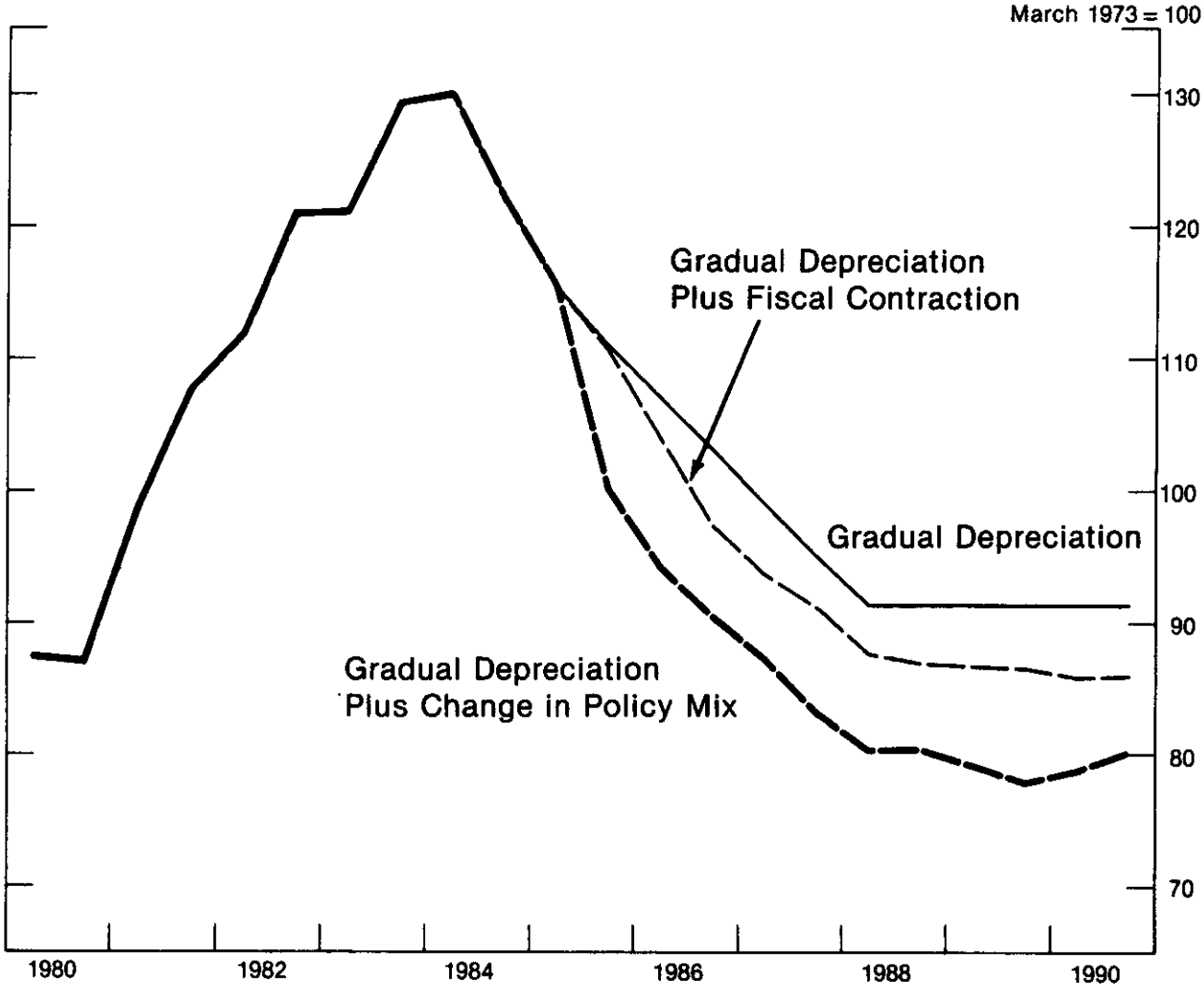
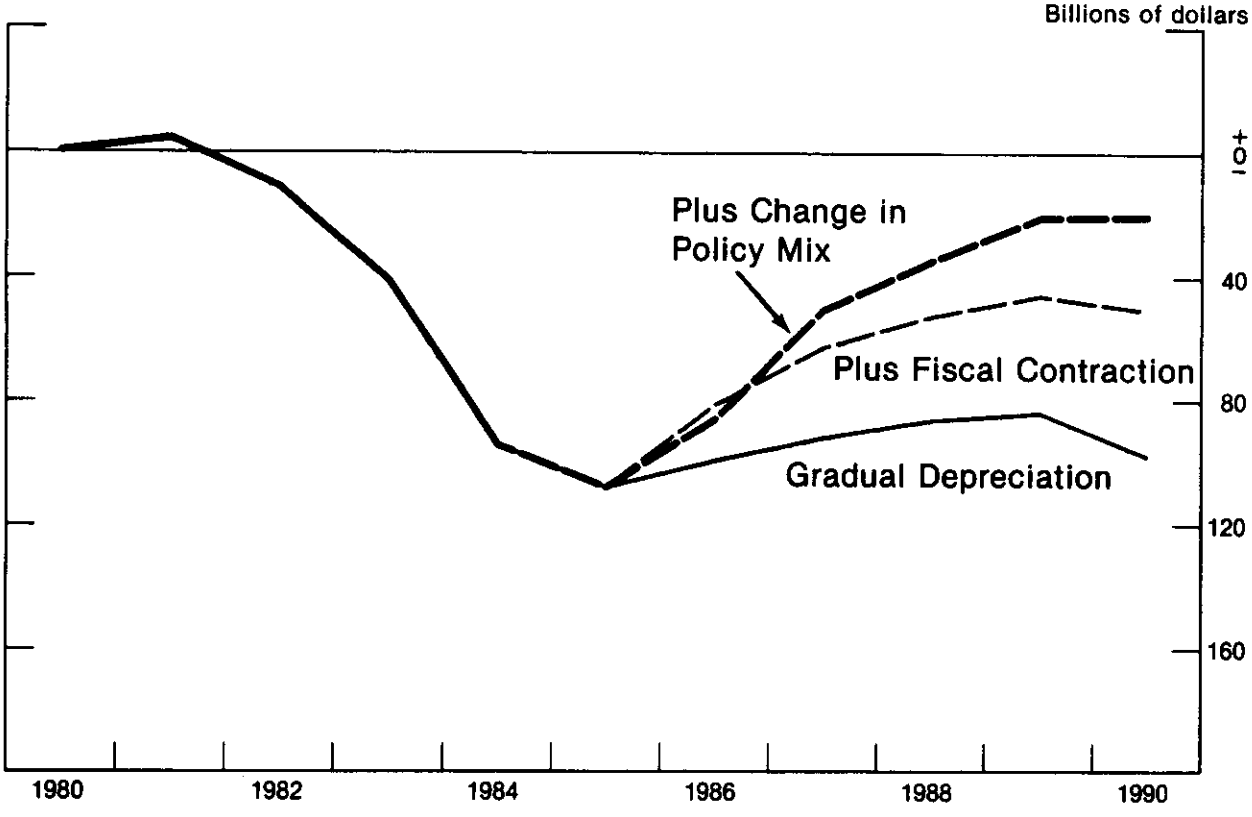


Chart 20

Effects on U.S. External Position

Current Account



External Investment Position Relative to GNP

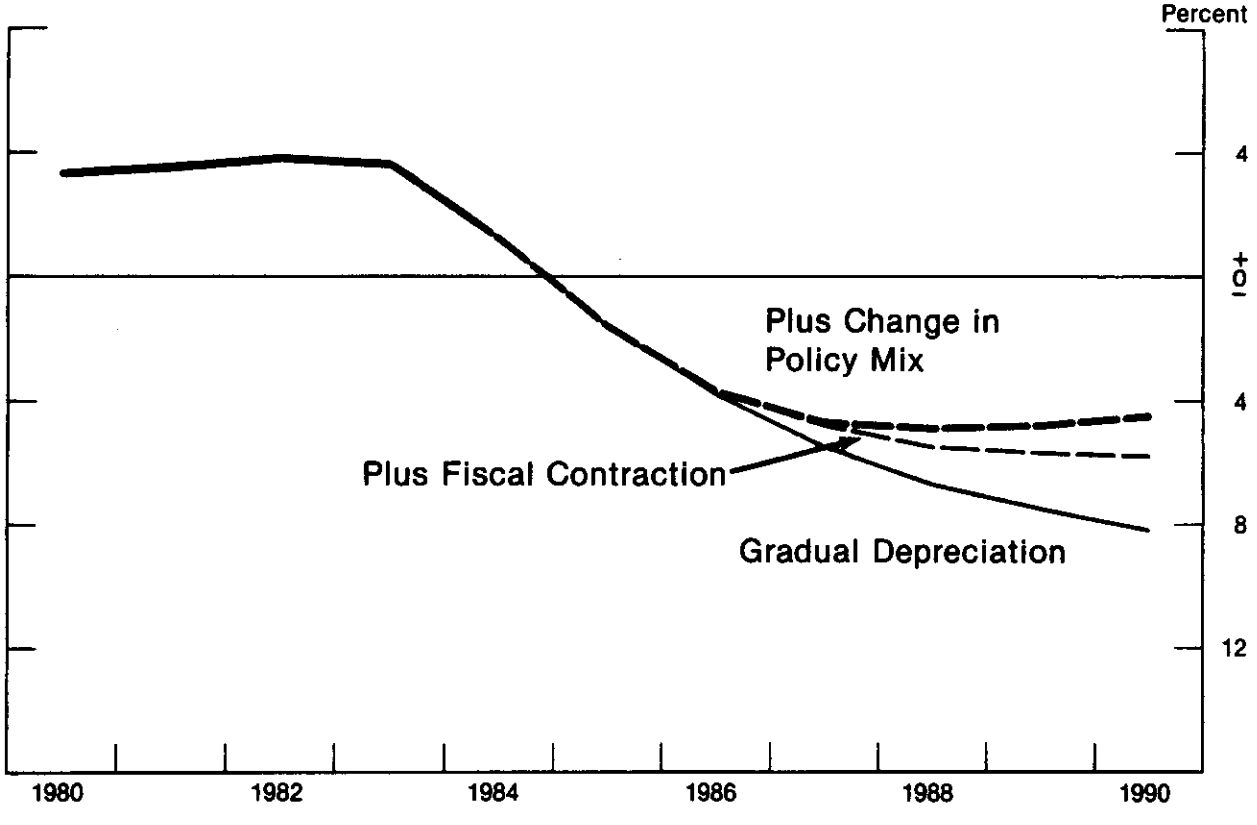
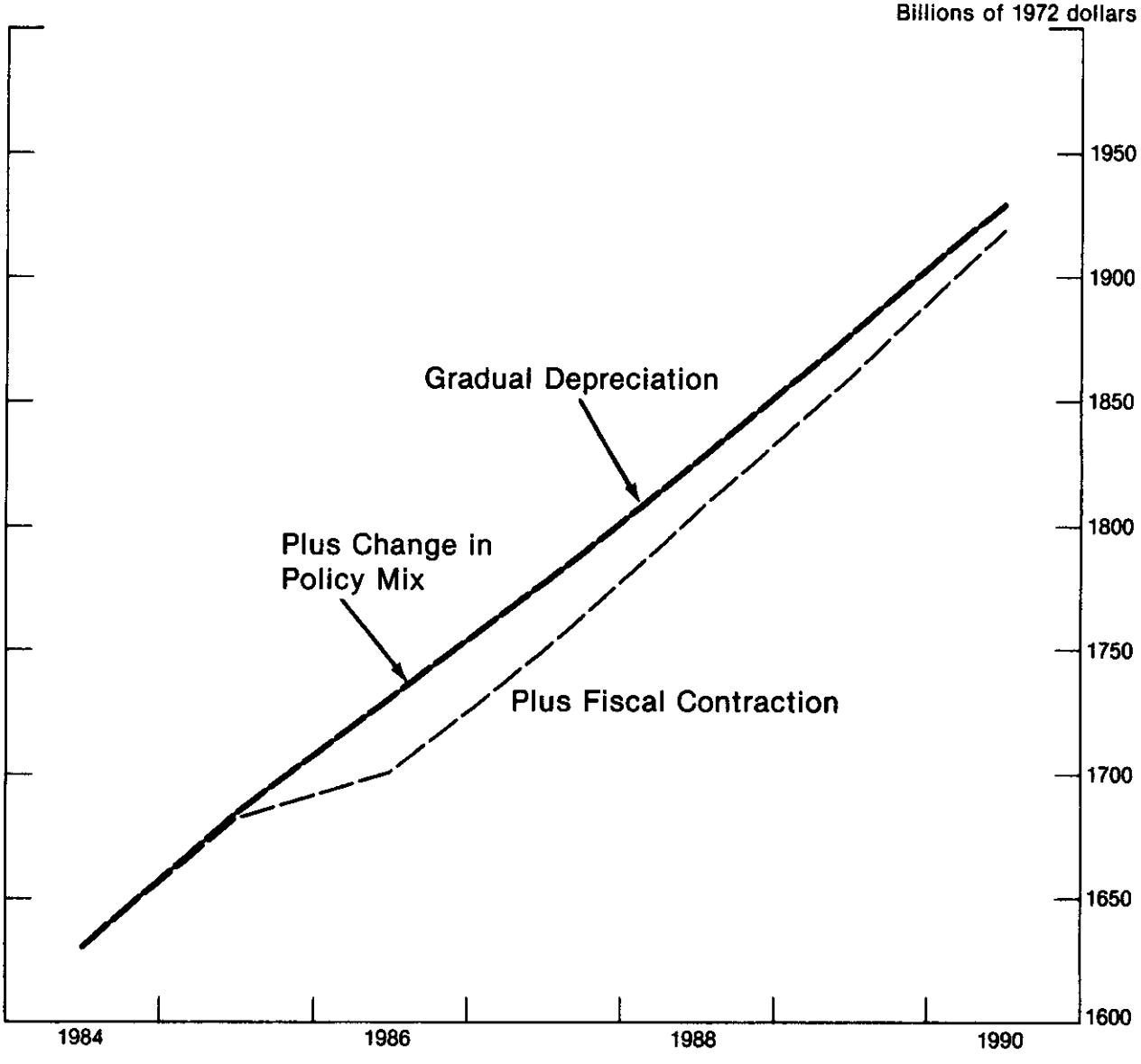


Chart 21

Effects on U.S. Economy

Real GNP



Inflation

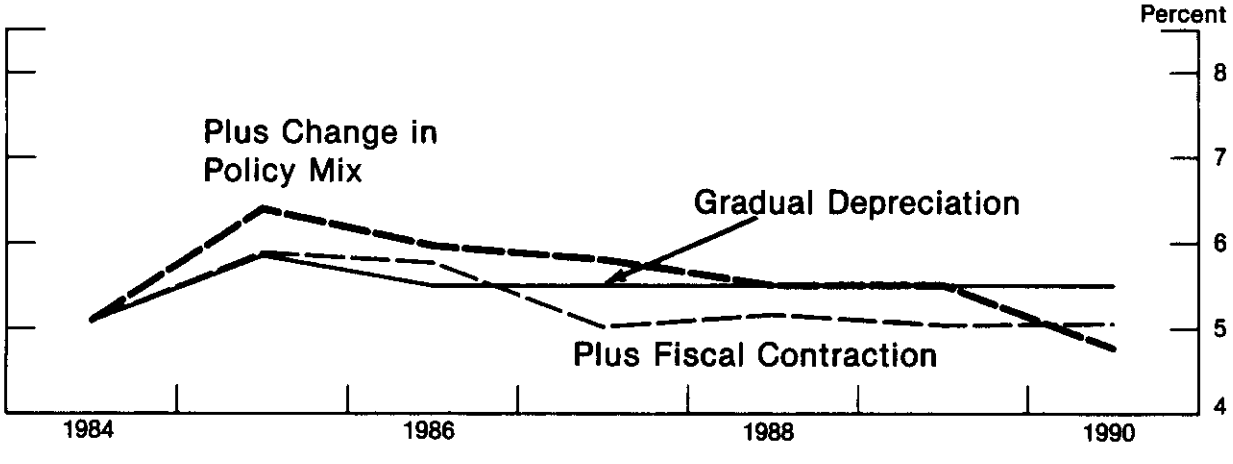
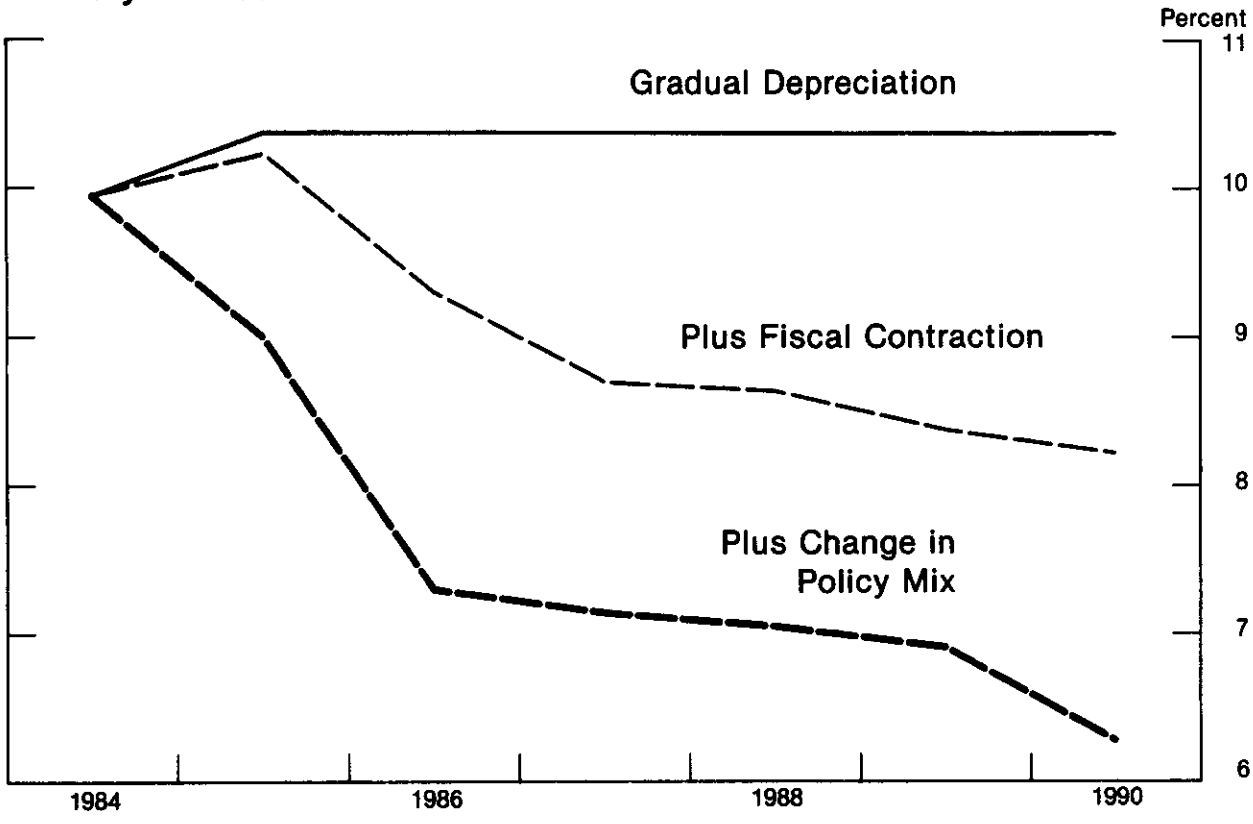
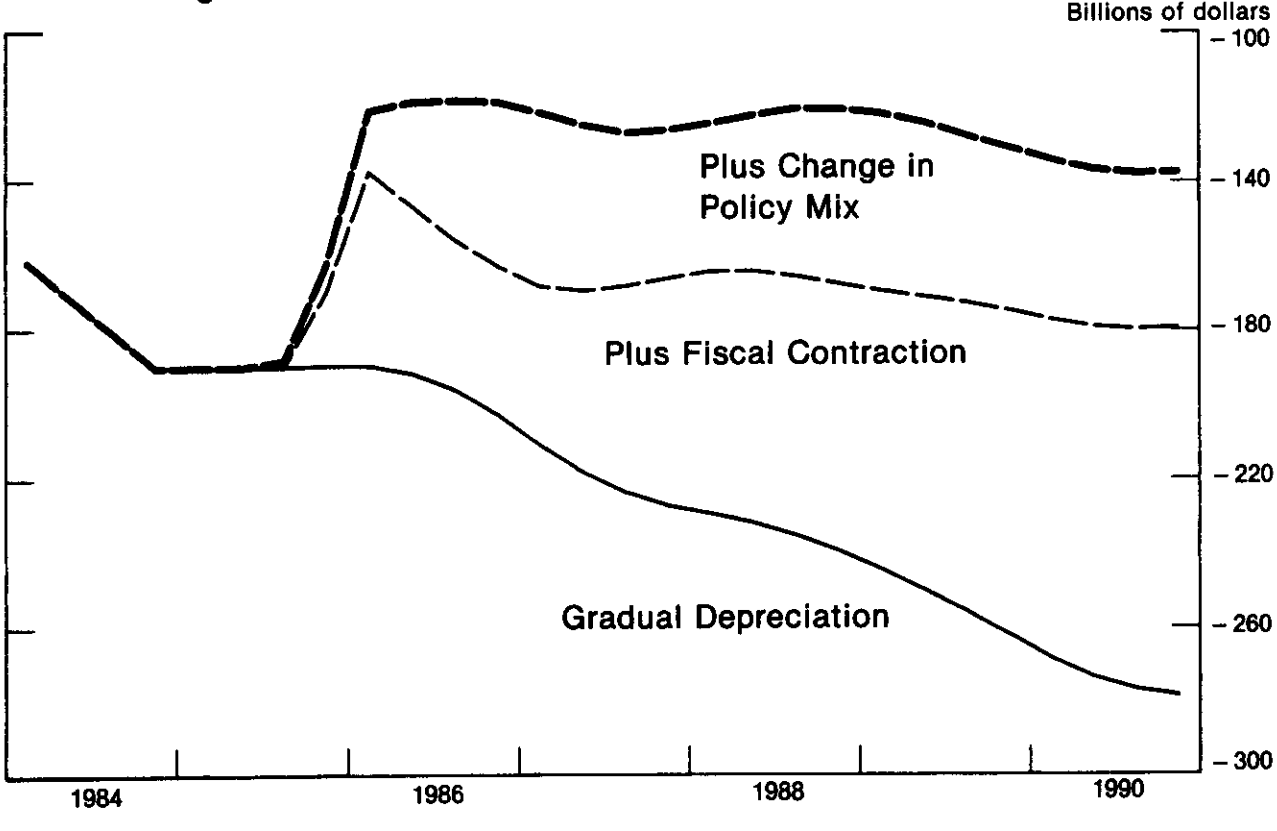


Chart 22

Treasury Bill Rate



Federal Budget Deficit