FOR AGENDA

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Supplement 1

CONTAINS CONFIDENTIAL INFORMATION

August 1, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: United States - Staff Report for the 1984 Article IV Consultation

The attached supplement to the staff report for the 1984 Article IV consultation with the United States has been prepared on the basis of additional information.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Hernández-Catá (ext. (5)8486).

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INTERNATIONAL MONETARY FUND

UNITED STATES

Staff Report for the 1984 Article IV Consultation
Supplementary Material

Prepared by the Western Hemisphere Department

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This note summarizes information that has become available since the staff papers for the 1984 Article IV consultation with the United States were issued.

1. Recent developments and economic outlook

According to preliminary national accounts data released on July 23, real GNP rose at an annual rate of 7 1/2 percent in the second quarter of 1984, following an increase of about 10 percent in the first quarter. The implicit price deflator for GNP rose at an annual rate of of 3 1/4 percent in the second quarter after increasing by nearly 4 1/2 percent in the first quarter. During the year ended in the second quarter of 1984, real GNP increased by 7 1/2 percent and the GNP implicit deflator rose by 3 3/4 percent; during the preceding four-quarter period real GNP and the deflator had increased by 3 percent and 3 1/2 percent, respectively.

The deceleration of real GNP growth in the second quarter was more than accounted for by a slowdown in the pace of business inventory accumulation. Final domestic demand in real terms grew at an annual rate of 10 3/4 percent in the second quarter, substantially more than the 6 1/4 percent rise registered in the first quarter.1/ All major components contributed to the acceleration in real final domestic demand, with the exception of residential construction which expanded at a considerably slower pace in the second quarter than in the first. Business fixed investment continued to show considerable strength, rising at an annual rate of a little more than 20 percent in real terms.

The preliminary data for the second quarter of 1984 were accompanied by revisions in the national accounts estimates dating back to 1981.

1/ The increase in final demand in the second quarter, as well as the slowdown in the pace of inventory accumulation, reflected in part the ending of transfers of commodities to farmers from federal government stocks under provisions of the Payment-in-Kind (PIK) program. In the first quarter, the PIK transactions--which do not affect total GNP--had substantially increased farm inventories and correspondingly reduced net purchases of farm products by the Federal Government.

Real GNP was revised downward by relatively small amounts in each of the three years 1981-83, with largely offsetting revisions in various components. Revisions to the GNP implicit price deflator also were small for all three years. As regards the income side of the accounts, revisions in personal income and outlays resulted in small upward revisions in personal savings and the saving rate. Overall, the revisions to the national accounts data do not affect the reading of economic developments in recent years in any major way.

On the basis of the recent national accounts data, it is now apparent that the current recovery is very strong by the standards of previous postwar upswings. During the six quarters ended the second quarter of 1984, real GNP rose by 7 1/4 percent at an annual rate compared with an average increase of 5 3/4 percent during the corresponding period in previous postwar recoveries (see following tabulation).

(Percentage changes at annual rates)

		Real				
			Fixed Investment			
	Nominal GNP	GNP	Residential	Non-Residential	Change in Inventories 1/	Net Exports 1/
1982:4 to 1984:2	11.3	7.2	32.3	16.3	2.1	-1.5
1975:1 to 1976:3	10.9	5.3	17.1	3.7	1.2	-0.3
Typical recovery 2/	9.1	5.8	17.1	6.2	1.1	-0.2

To a large extent, the growth of real GNP during the current recovery has reflected the strength of investment. As shown in the preceding tabulation, nonresidential fixed investment--particularly spending on producers' durable equipment--has increased at a pace considerably faster than in the typical recovery; the growth of residential investment also has been very strong by historical standards. In addition, changes in inventories have accounted for a substantial portion of the growth of output during this recovery; the shift from liquidation to accumulation of business inventories during the past year and a half was equivalent to 2 percent of GNP, at an annual rate, compared with an average of around 1 percent during previous upturns. A major factor offsetting these sources of strength has been a decline in real net

1/ As percent of real GNP at the recession trough.
2/ First six quarters of the average of postwar recoveries. For details, see Appendix I to the recent economic developments paper (SM/84/178, Sup. 1).

exports of goods and services equivalent to 1 1/2 percent of GNP (annual rate) during the past six quarters; by way of comparison, the real foreign balance had deteriorated by 1/4 percent of GNP during the comparable period of the average recovery.

The consumer price index for all urban consumers (CPI-U) rose by 0.2 percent in June 1984, the same increase as in the previous month, but down from the 0.4 percent average rise registered during the first four months of the year. The 12-month rate of increase in the CPI-U was 4.2 percent in June 1984, compared with 4.7 percent in March 1984 and a low of 2.4 percent in July 1983. The composite index of leading economic indicators fell by 0.9 percent in June 1984, following increases of 0.4 percent in May and 0.5 percent in April. During the first six months of 1984, the index rose at an annual rate of 4.8 percent, compared with 8 percent during the second half of 1983.

The staff has updated the projections for the U.S. economy that were presented in the staff report (SM/84/162, p. 28), taking into account the recent revisions of the national accounts data and other information that has become available in recent weeks. In 1984, the increase in output is now expected to be a little larger than had been foreseen earlier; no significant changes have been introduced in the projections for 1985. (The revised national accounts data and the updated staff projections are presented in Table 1.)

2. Fiscal policy

On July 18, the President signed into law the Deficit Reduction Act of 1984, which contained measures designed to lower federal fiscal deficits by $62 billion in the period FY 1984-FY 1987. Of the total deficit reduction envisaged, about $50 billion would be accounted for by a variety of revenue raising measures. This legislation, together with the Farm Bill and the 1983 Reconciliation Act (both of which were enacted previously), represents part of the "downpayment" package that had been proposed by the President. In total, these three pieces of legislation would reduce the federal deficit by $73 billion in FY 1984-FY 1987 (see following tabulation).1/ This amount is close to the deficit reduction that was envisaged in the Administration's original budget proposals presented in February 1984. In addition, discussions are currently underway in a conference committee of the House and Senate to work out a plan to reduce defense spending and outlays in programs that require annual appropriations. Action in this area could lead to further reductions

1/ The $73 billion deficit reduction is with respect to the current services estimates contained in the FY 1985 budget adjusted for the reduction in defense spending proposed in that budget ($13 billion in both FY 1985 and FY 1986 and $6 billion in FY 1987). Taking into account the Bills that have been enacted and on the basis of the economic assumptions underlying the April update of the FY 1985 budget, the federal deficit would rise from about $176 billion in FY 1984 to $186 billion in FY 1987.

in the federal deficit ranging from $55 billion to $70 billion over the period FY 1984-FY 1987. In the context of the mid-session budget review, the Administration will soon present an update of fiscal projections, on the basis of a revised economic forecast, technical reestimates of expenditures and receipts, and recently enacted legislation.

Estimated Effects of Deficit Reduction Measures
Contained in Recent Legislation

(In billions of dollars; fiscal years)

	1984	1985	1986	1987	Total
1984 Deficit Reduction Act	1.0	13.7	20.1	27.1	61.9
Farm Bill	0.3	1.0	0.8	3.2	5.3
1983 Reconciliation Act	0.5	0.9	1.9	2.4	5.7
Total	1.8	15.6	22.8	32.7	72.9

3. Monetary policy

In the Mid-Year Monetary Policy Report submitted to the Congress on July 20, the Federal Reserve reassessed the target ranges it had adopted for monetary growth in 1984 and announced preliminary targets for 1985. For the remainder of 1984, it was decided that previously established ranges for the monetary aggregates would be retained. The Federal Reserve noted in this connection that in the first half of 1984 M-1 and M-2 were within their respective target ranges while M-3 and the debt variable had expanded at rates somewhat faster than had been envisaged. In setting targets for monetary growth in 1985, the Federal Reserve reaffirmed its intention to lower over time the growth of money and credit to rates consistent with progress toward price stability in an environment of sustainable economic growth. Specifically, the upper limits for the growth of M-1 and M-2 were lowered by 1 percentage point and 1/2 percentage point, respectively; the lower limits for these aggregates were kept unchanged. As for M-3 and domestic nonfinancial sector debt, the Federal Reserve retained for 1985 the ranges applicable in 1984 (see following tabulation).

Targets for the Monetary Aggregates

(Percentage changes; from fourth quarter to fourth quarter)

	M-1	M-2	M-3	Debt 1/
1984	4 to 8	6 to 9	6 to 9	8 to 11
1985	4 to 7	6 to 8 1/2	6 to 9	8 to 11

1/ Debt of domestic nonfinancial sectors.

The report noted that in view of the evidence of more typical cyclical behavior of M-1 in recent quarters the Federal Reserve considered it appropriate to give roughly equal weight to all of the monetary aggregates in implementing policy in the period ahead. As was mentioned in the staff report, the marked deviation in the behavior of M-1 from its historical pattern in 1982 and early 1983 had increased uncertainty about the interpretation of that aggregate; as a result, greater emphasis had been placed on the broader aggregates. The Monetary Policy Report also indicated that movements of the monetary aggregates and the relationships among them would continue to be assessed in the light of developments in economic activity, inflationary pressures, financial market conditions, and the rate of credit expansion.

In presenting the report to the Congress, the Chairman of the Federal Reserve said that, in implementing the policies reflected in the various targets, steps had been taken early in 1984 to increase somewhat the pressure on bank reserve positions. He indicated that subsequently pressure on reserves had not changed appreciably. With both M-1 and M-2 remaining within their target ranges, and given economic and financial developments, stronger restraining measures on money and credit growth generally had not appeared appropriate to the Federal Reserve. The Chairman also noted that, although pressures on bank reserves had not increased further, both long- and short-term interest rates had risen in recent months, a development that he attributed to continued heavy credit demand and fears of a resurgence of inflationary pressures as resources became more fully utilized.

4. Trade policy actions

On July 25, the U.S. International Trade Commission (ITC) settled the remaining escape clause petition pending before it. The ITC found that imports of water-packed tuna were not a substantial cause of serious injury to the U.S. industry. This ruling marked the third rejection of an escape clause petition by the ITC this year. As was mentioned in Appendix VIII to the recent economic developments paper, other petitions rejected were those filed by the stainless steel tableware and nonrubber footwear industries. In two other cases this year (copper and carbon steel), the ITC has issued affirmative determinations of injury and made specific recommendations on types of import protection to the President.1/ The President has until late September to make a decision as to whether import relief will be granted and, if granted, what form it might take.

1/ See SM/84/178, Sup. 1, Appendix VIII.

Table 1. United States: Projections of Selected Economic Indicators

(Percentage changes from preceding year, except as indicated)

	1980	1981	1982	1983	Proj. 1984	Proj. 1985
Gross national product (in constant prices)	-0.3	2.5	-2.1	3.7	7.3	4.0
Consumer expenditure	0.5	2.0	1.4	4.8	5.7	4.2
Government expenditure	2.2	0.9	2.0	0.3	2.9	3.6
Residential construction	-20.3	-5.5	-14.8	41.7	14.7	0.5
Nonresidential fixed investment	-2.4	5.5	-4.6	2.5	19.6	7.9
Final domestic demand	-0.4	2.0	0.3	4.4	7.0	4.4
Stockbuilding 1/	-0.8	1.1	-1.4	0.5	1.8	-0.3
Total domestic demand	-1.2	3.1	-1.2	4.9	8.8	4.1
Foreign balance 1/	0.9	-0.4	-0.9	-1.2	-1.5	-0.1
Output, employment, and costs						
Industrial production	-3.6	2.6	-8.1	6.4	11.8	7.5
Employment	0.5	1.1	-0.9	1.3	4.6	2.8
Unemployment rate, civilian 2/	7.2	7.6	9.7	9.6	7.4	6.8
Hourly compensation in the manufacturing sector	11.7	9.8	8.5	5.3	4.6	5.2
Prices						
GNP deflator	9.2	9.6	6.0	3.8	3.9	4.4
Consumer price index	13.5	10.3	6.2	3.2	4.5	5.0
Foreign trade						
Export unit value	13.6	9.2	1.3	1.1	3.8	4.9
Import unit value	25.4	5.5	-1.6	-4.1	0.8	1.7
Terms of trade	-9.4	3.5	2.8	5.4	3.0	3.1
Volume of exports	7.0	-3.2	-11.9	-6.2	6.5	3.6
Volume of imports	-6.0	0.7	-5.0	10.0	27.8	11.1
Current external transactions (in billions of dollars)						
Trade balance	-25.5	-28.0	-36.5	-61.1	-115.3	-139.8
Balance on services and private transfers	32.1	38.7	32.7	25.5	31.0	30.7
Current balance, excluding official transfers	6.6	10.7	-3.8	-35.5	-84.3	-109.0
Current balance, including official transfers	1.9	6.3	-9.2	-41.6	-90.0	-115.0

1/ Change as a percent of GNP in the previous year.
2/ Annual averages, in percent.