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July 19, 1983

To: Members of the Executive Board

From: The Acting Secretary

Subject: United States - Staff Report for the 1983 Article IV Consultation

The attached supplement to the staff report for the 1983 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. 74143.

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INTERNATIONAL MONETARY FUND

UNITED STATES OF AMERICA

Staff Report for the 1983 Article IV Consultation Supplementary Material

Prepared by the Western Hemisphere Department

Approved by Joaquin Ferran and W.A. Beveridge

July 18, 1983

This note summarizes information that has become available since the staff papers for the 1983 Article IV consultation with the United States were issued.

1. Recent economic data and outlook

Data that became available in recent weeks suggest that the recovery of economic activity has proceeded at a faster pace than had generally been anticipated. Industrial production rose by 4-1/4 per cent from March to June with strong gains registered in all major categories; the level of industrial output in June was more than 8 per cent above the trough in November 1982. Following two months of decline, in May housing starts rose to 1.8 million (annual rate), the highest level in three-and a-half years. The growth of employment also has been strong in recent months. Civilian employment (household survey) rose sharply in June, bringing the cumulative increase from March to June to nearly 1.7 million. The civilian unemployment rate has declined gradually from its peak of 10.8 per cent in December 1982 to 10 per cent in June 1983. According to preliminary estimates by the Commerce Department, real GNP expanded at an annual rate of a little above 6-1/2 per cent in the second quarter.

While the rapid growth of output in the second quarter apparently reflected in large measure a sharp turnaround in inventories--from a sizable liquidation to a modest accumulation--there are signs that final domestic demand also has been gathering momentum. Retail sales in nominal terms went up by nearly 6 per cent (actual rate) in the second quarter; auto sales were particularly strong, increasing by about 12 per cent in volume. Business fixed investment, which fell sharply in the latter part of 1982, is estimated to have increased a little in the first half of this year. It may also be noted that, according to the latest flow of funds data, in the first quarter of 1983 the volume of funds raised by private nonfinancial sectors in credit markets was considerably larger than in the second half of 1982.

In late June, the Administration revised its economic projections in preparation for the midyear budget review. According to the new projections, real GNP would increase by 5.5 per cent during 1983 (i.e., from the fourth quarter of 1982 to the fourth quarter of 1983) and by 4.5 per cent during 1984; this compares with rates of growth of 4.7 per cent and 4.0 per cent, respectively, that had been projected at the time of the April budget revision. On a year-over-year basis real GNP would rise by 3.1 per cent in 1983 and by 5.2 per cent in 1984. The forecast for the growth of real GNP in subsequent years was left unchanged at 4 per cent. Employment would expand at a faster pace than had been expected earlier and the unemployment rate would fall to 9.6 per cent in the final quarter of this year and to 8.6 per cent in the final quarter of next year. The forecast for inflation was left virtually unchanged.

The staff is in the process of revising its forecast for the U.S. economy in the context of the World Economic Outlook exercise that will be completed in August. The preliminary projections discussed below are based on the assumption that the growth of the broader monetary aggregates during 1983 will be around the upper end of the target ranges specified by the Federal Reserve and that there will be a modest reduction in monetary growth during the following year. On the fiscal side, it is assumed that the overall stance of policy will be along the lines of the Administration's proposals; the First Concurrent Resolution (discussed below) indicates that the overall fiscal policy stance that the Congress is seeking is not materially different from that implied by the Administration's budget.

On the basis of these assumptions and allowing for the recent strengthening of private demand, the staff now estimates that during 1983 real GNP would grow by 5 per cent, compared with 4 per cent foreseen in the previous forecast. Final domestic demand in real terms is projected to rise by about 3-3/4 per cent during 1983 and the turnaround in inventory behavior is expected to contribute about 2 percentage points to the growth of real GNP. Personal consumption expenditure and residential construction would show considerable strength and nonresidential fixed investment would register a modest increase. There would be a small decline in government purchases, partly reflecting a temporary bulge in this component in the final quarter of 1982. The growth of real GNP is projected to slow during 1984 (to less than 4 per cent) as the inventory cycle runs its course; final domestic demand in real terms would increase a little faster during 1984 than during 1983. On a year-over-year basis, real GNP would grow by about 3 per cent in 1983 and by somewhat more than 4 per cent in 1984.

The stronger output growth projected for 1983-84 implies an improved outlook for employment, and the staff now estimates that the unemployment rate will fall to around 9 per cent by the end of the period, compared with a little less than 9-1/2 per cent forecast earlier. Unit labor costs would continue to slow this year in reflection of a further, albeit small, deceleration in wages and a pickup in productivity growth. Unit labor costs are expected to accelerate a little next year as the rate of growth of productivity would come down from the rapid pace envisaged for the first year of recovery. The GNP deflator is forecast to increase by 4-1/4 per cent during 1983 and 4-3/4 per cent during 1984. The consumer price index would rise by 3-1/4 per cent during 1983 and at about the same rate as the GNP deflator during 1984. To some extent, the rise in inflation from 1983 to 1984 would reflect the acceleration in the prices of energy and primary commodities that is now in prospect; the weakening of those prices had contributed to the moderation of inflation in 1982 and early 1983.

The staff's forecast for the external sector is being updated on the basis of the revised projections for the domestic economy discussed above. Preliminary estimates suggest that the current account deficit in both 1983 and 1984 would be larger than that foreseen in the previous World Economic Outlook, as the deficit on merchandise trade would be higher and the surplus on services transactions would be smaller. The larger trade deficit would be the result of an upward revision in the forecast for the growth of real GNP in the United States and a downward revision in the projection for agricultural exports. The lowering of the estimated surplus on services transactions reflects largely a downward revision in the data for the final quarter of 1982 and the weaker than expected performance in the first quarter of 1983.

While the staff envisages a somewhat stronger recovery of economic activity in 1983-84 than had been projected earlier, questions remain about the outlook for growth beyond the short run. As was noted in the staff report (SM/83/135, 6/20/83, p. 25), large prospective fiscal deficits and the attendant increase in government debt would tend to preempt savings, with adverse effects on capital formation and productivity growth, and could generate uncertainty about the Government's commitment to anti-inflationary policies. Furthermore, M-1 has been rising strongly for some time and, although the interpretation of M-1 is subject to a great deal of uncertainty, there is a danger that continued rapid growth could result in a wage-price performance in the period ahead less favorable than that envisaged in the staff's forecast.

2. The First Concurrent Budget Resolution

In late June, the Congress adopted the First Concurrent Budget Resolution which called for deficits in FY 1983-FY 1986 somewhat smaller than those estimated in the Administration's April budget revision (see following tabulation). The differences result largely from changes in economic assumptions and technical reestimates. The overall fiscal policy stance implied by the Resolution is thus broadly similar to that implied by the Administration's budget. However, there are differences in the composition of spending; the Resolution envisages lower defense outlays and larger nondefense expenditures than the Administration's budget proposals.

Budget Plans

(In billions of dollars)

	1983	1984	1985	1986
Concurrent Resolution				
Receipts	604	680	751	836
Outlays	813	859	912	967
Deficit	209	179	161	131
Administration's budget 1/				
Receipts	598	654	732	844
Outlays	809	844	917	988
Deficit	210	190	185	145
Administration's budget: adjusted 2/				
Receipts	604	670	741	836
Outlays	808	841	902	968
Deficit	203	171	162	132

3. Import restraint measures on specialty steel

Following an investigation under the escape clause that had been initiated in November by Presidential directive, the International Trade Commission (ITC) recommended in May 1983 that quotas be imposed on imports of specialty steel products in order to stem their penetration of the U.S. market.3/ On July 5, 1983, the President announced import relief measures that were described as necessary to counter unfair trading practices by other countries. The measures, which are to become effective within 15 days of the announcement, are scheduled to be in effect for four years. It was indicated that an annual review would be undertaken to assess the necessity for and effectiveness of the relief measures.

The measures include increases in existing tariffs and the imposition of quotas. For flat rolled products (which account for about 55 per cent of imports of specialty steel), digressive ad valorem tariffs over four years were imposed. In the first year tariffs were increased by 10 percentage points for stainless steel sheet and strip and by 8 percentage points for stainless steel plate; in each of the following three years the increments would be reduced by 2 percentage points. In recognition of the weaker competitive position of stainless steel rod, bar, and alloy tool producers, global quotas were imposed

1/ As revised in April 1983.
2/ The Administration's budget (as revised in April 1983), reestimated by the Congressional Budget Office on the basis of economic assumptions and estimating techniques used in the First Concurrent Resolution.
3/ See Appendix VII to the recent economic developments paper (SM/83/152, 7/6/83), p. 81.

for these products. In the first year, imports will be limited to 19,100 tons for rod, 27,000 tons for bar, and 22,400 tons for tool steel. By way of comparison, in 1982 imports amounted to about 22,000 tons for rod, 40,000 tons for bar, and 38,000 tons for tool steel. Quotas will be increased by 3 per cent a year in the following three years. Quotas may be allocated on a country basis; alternatively, orderly marketing agreements may be negotiated with countries that request such negotiations.