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EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

November 10, 1988

MEMORANDUM FOR T-1: Nicholas F. Brady, Treasury
Beryl W. Sprinkel, CEA
Joseph R. Wright, OMB

FROM: T-2: Michael R. Darby, Treasury
Allan H. Meltzer, CEA *Allan H. Meltzer*
John C. Weicher, OMB *John C. Weicher*

SUBJECT: Revision of Administration Economic Assumptions
for the FY1990 Budget

To prepare for projections of the Federal budget for FY1990, T-1 must soon decide on revisions of the Administration's economic assumptions to recommend to the President. The date for public release of the revised assumptions must also be determined, in line with a schedule consistent with publication of the Budget document in early 1989.

Revisions to the Administration's assumptions are required to take account of developments since the preparation of the Mid-Session forecast. The economic effects of the drought are larger than previously anticipated; this reduces real GNP growth in 1988 by 0.7 percentage point and restores the loss in 1989. Oil prices have declined and are expected to decline somewhat further in the near term. Long-term and, particularly, short-term interest rates have risen in contrast to the declines forecast in the Mid-Session projections. Adjustments to the Administration's previous projections to take account of these factors are essentially viewed as mid-course corrections and are not seen as affecting projections of the underlying long-term expansion path of the economy.

To reflect the effects of the drought, T-2 recommends reducing the forecast for real GNP growth from 3.0 to 2.6 percent (fourth quarter to fourth quarter) in 1988, as shown in Table 1. (This is equivalent to 3.3 percent on the pre-drought basis.) All of the effects of the drought on economic growth are reversed in 1989. Table 1 shows two sets of recommendations for revisions in the Administration's economic assumptions for 1989. A majority of T-2 expects somewhat slower growth in the nonfarm sectors of the economy than previously assumed. The combined effect of slower growth and the drought raises the forecast for 1989 from 3.3 percent to

3.5 percent (fourth quarter to fourth quarter). Slight increases in GNP growth in 1990 and 1991 are recommended to compensate for revisions to growth in 1988 and 1989 while maintaining the underlying growth rate in the majority forecast unchanged. The adjustments keep the average rate of growth over the full projection period at the level established in both the Mid-Session and January 1988 Budget projections.

Only two revisions are recommended for inflation rates: an upward revision to the GNP deflator from 3.5 to 3.9 percent in 1988 to reflect slightly higher-than-expected increases so far this year, and a downward revision from 3.9 to 3.7 percent for the CPI in 1989, partly to take into account lower anticipated oil prices. Projections of short- and long-term interest rates for 1988 and 1989 are revised upward to reflect what has occurred since the Mid-Session projections. The projected increases represent a decline from current levels. Projected slower real growth in nonfarm sectors of the economy during 1989, and lowered expectations of inflation, partly the result of lower oil prices, are assumed to relieve part of the recent upward pressure on interest rates. (Long rates are now below their August highs.)

Real GNP Growth and the Unemployment Rate

The downward revision to real GNP growth in 1988 is more than explained by the estimated 0.7 percent negative impact on GNP growth for the year resulting from the effects of the drought on farm output and inventories. (The projection of 1.7 percent real GNP growth in the fourth quarter of 1988 reflects a 1.3 percentage point loss to growth due to the drought.) The drought-related loss to GNP is offset somewhat by slightly stronger-than-expected growth elsewhere in the economy during the year; this accounts for the less than 0.7 percent downward revision to 1988 growth relative to our previous projections.

The upward revision to GNP growth in 1989 on the majority path reflects a 0.7 percentage point rebound in growth due to the end of the drought, partly offset by some lowering of expectations for growth in the nonfarm sectors of the economy. Slower growth in the nonfarm sectors in part reflects the tightening of monetary policy during 1988. In line with growth in recent months, the pace of real consumer purchases is expected to continue to slow from the fast pace of the first three quarters of this year. Also, the majority believes that the rate of growth in real business fixed investment and in real net exports experienced in 1988 will moderate somewhat next year.

As indicated in Table 2 (attached), the Blue Chip consensus forecast for real GNP growth published today projects 2.2 percent growth in 1989, 1.3 percentage points below the majority recommendation of 3.5 percent. However, it appears

that the Blue Chip projections do not totally reflect the effects of the drought and are likely to be raised in coming months. Excluding drought effects, the majority recommendation is estimated to be about 0.5 to 1.0 percentage point above the consensus.

The majority believes that the revised growth pattern outlined above for 1988 and 1989 does not materially affect the longer term growth potential of the U.S. economy. Thus, slight upward revisions to growth of 0.1 percentage points are recommended for 1990 and 1991 respectively, to offset the accumulated decreases for 1988 and 1989 relative to our previous forecast. This adjustment will hold the average for real GNP growth to approximately 3.2 percent, the same as in the Mid-Session and January 1988 Budget projections.

Since most of the revisions to the GNP projections are drought related and are assumed to have little effect on employment, T-2 recommends no change to the rates of unemployment established in the Mid-Session Review.

Alternative Path for Real Growth

One member of T-2 has proposed an alternative path for real GNP growth, for 1989. This recommendation is that the growth rate be 3.9 percent. Removing the effects of the drought, this is equivalent to a 3.2 percent growth rate for 1989, 0.1 percent below the Mid-Session Review. The alternative path is proposed on the basis that the Mid-Session Review forecast for real growth has been accurate to the present, and there is no compelling reason to change it. The economy is expected to continue near its long-term growth path, in 1989 and later years.

Inflation Rates

So far this year, prices have risen at a slightly faster pace than previously projected, owing partly to the effects of the drought on food prices. The recommended upward revision to the GNP deflator for 1988 embodies price increases that have already occurred.

The CPI also reacted to food price increases in 1988 and will begin to reflect lower oil prices in 1989. The average refiner's acquisition cost of oil is currently close to \$14 a barrel, down from an average of \$15.7 in the first half of the year and is expected to fall further. The GNP deflator, which is only indirectly affected by foreign crude oil prices, is unrevised for 1989.

Interest Rates

Owing to stronger-than-expected growth this year, rising inflation expectations, and tightened Fed policy, interest rates continued to rise since the Mid-Session forecast rather than fall as previously projected. T-2 recommends that the annual rate for 10-year and 91-day Treasuries be revised up to reflect the recent experience but that the upward revisions be reduced in later years in order to return to the Mid-Session assumptions by 1991 or 1992 and in later years. The decline in rates from current levels, projected for 1989, indicates a belief that recent accelerated price increases are temporary and inflation expectations will continue to decline as they have since August. (Declining oil prices will reinforce this development.) Our interest rate projections also reflect the assumption that the nonfarm economy will slow somewhat next year from this year's pace. After peaking in August, long rates have been declining but have not yet reached the values projected in the Mid-Session Review.

Policy Assumptions

As always, the Administration's economic projections are conditional on critical assumptions about economic policy. T-2 assumes that monetary policy will continue to support sustainable economic growth, while the Federal Reserve gradually pursues the long-term objective of price stability. Fiscal policy is assumed to achieve roughly the deficit reduction objectives of the Gramm-Rudman-Hollings Act through economic growth and spending restraint and without an increase in tax rates.

Attachments

TABLE 1

Fourth Quarter to Fourth Quarter Growth Rates

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
Real GNP								
Mid-Session Review	4.0	3.0	3.3	3.3	3.2	3.2	3.2	
Majority Recommendation	5.0	2.6	3.5	3.4	3.3	3.2	3.2	3.2
T-2 Alternative	5.0	2.6	3.9	3.4	3.3	3.2	3.2	3.2
NP Implicit Deflator								
Mid-Session Review	3.3	3.5	3.7	3.5	3.0	2.5	2.0	
T-2 Recommendation	3.1	3.9	3.7	3.5	3.0	2.5	2.0	1.5
PI - All Urban								
Mid-Session Review	4.5	4.3	3.9	3.5	3.0	2.5	2.0	
T-2 Recommendation	4.5	4.3	3.7	3.5	3.0	2.5	2.0	1.5

Levels (Annual Average)

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
3-Month T-Bill Rate								
Mid-Session Review	5.8	6.0	5.5	5.0	4.5	4.0	3.5	
T-2 Recommendation	5.8	6.6	6.3	5.5	4.5	4.0	3.5	3.0
10-Year T-Note Rate								
Mid-Session Review	8.4	8.5	8.1	7.1	6.0	5.0	4.5	
T-2 Recommendation	8.4	8.8	8.3	7.3	6.0	5.0	4.5	4.0
Total Unemployment Rate								
Mid-Session Review	6.1	5.5	5.2	5.1	5.0	5.0	5.0	
T-2 Recommendation	6.1	5.4	5.2	5.1	5.0	5.0	5.0	5.0

TABLE 2

Comparison of Short Term Economic Forecasts

	Percent Change (4Qtr to 4Qtr)			Percent (average for year)	
Real GNP	1988	1989	Civilian Unemployment Rate (2)	1988	1989
-----	-----	-----	-----	-----	-----
Data Resources, Inc. (Nov.1988)	2.5	2.0	Data Resources, Inc.	5.5	5.6
Wharton (Nov.1988)	2.7	2.4	Wharton	5.5	5.5
L.H.Meyer & Assoc. (Nov.1988)	2.5	2.9	L.H.Meyer & Assoc.	5.5	5.4
Blue Chip Consensus (Nov.1988)	2.7	2.2	Blue Chip Consensus	5.5	5.5
CBO (Aug.1988)	2.6	2.7	CBO	5.5	5.5
Mid-Session Forecast (Jun.1988)	3.0	3.3	Mid-Session Forecast	5.6	5.3
T-2 Recommendation (Nov.1988)	2.5 2.6	3.5	T-2 Recommendation	5.5	5.3
Consumer Price Index - Urban			3-Mo. Treasury Bill Rate		
-----			-----		
Data Resources, Inc.	4.2	4.7	Data Resources, Inc.	6.6	7.5
Wharton	4.1	4.7	Wharton	6.6	7.7
L.H.Meyer & Assoc.	4.2	4.7	L.H.Meyer & Assoc.	6.6	7.0
Blue Chip Consensus	4.4	4.7	Blue Chip Consensus	6.7	7.1
CBO (1)	4.4	5.0	CBO	6.3	7.1
Mid-Session Forecast	4.3	3.9	Mid-Session Forecast	6.0	5.5
T-2 Recommendation	4.3	3.7	T-2 Recommendation	6.6	6.3
GNP Deflator			10-Yr. Treasury Note rate		
-----			-----		
Data Resources, Inc.	3.7	3.7	Data Resources, Inc.	8.8	9.1
Wharton	4.0	4.6	Wharton	8.8	9.7
L.H.Meyer & Assoc.	4.0	3.4	L.H.Meyer & Assoc.	8.8	8.7
Blue Chip Consensus	3.9	4.2	Blue Chip Consensus	NA	NA
CBO	3.6	4.2	CBO	8.9	9.1
Mid-Session Forecast	3.5	3.7	Mid-Session Forecast	8.5	8.1
T-2 Recommendation	3.9	3.7	T-2 Recommendation	8.8	8.3

(1) CPI-W

(2) Recommendation to the President is for the Total Unemployment Rate, which is generally 0.1 percentage points below the Civilian Unemployment Rate.

P R E L I M I N A R Y D R A F T

November 10, 1988
APPENDIX TO T-2 MEMO

The 1988 Omnibus Trade and Competitiveness Act requires that OMB, after consultation with the Chairman of the Council of Economic Advisers, include a "Federal Budget Competitiveness Impact Statement" in the annual Budget document. The Act calls for projections for the year of the budget only -- FY1990. The following table lists the categories for which numerical values are requested and shows preliminary values for suggested projections for several variables derived from the majority path.

National Income and Product Account (NIPA) basis	Estimated FY88	FY90
	(current dollars)	
a) Amount of borrowing by the Federal Government in private credit markets	143.8	*
b) Gross domestic savings, including personal savings, corporate savings, and fiscal surplus of State and local governments	271.0	*
c) Net private domestic investment	263.0	*
d) Merchandise trade account (net exports of goods)	-135.3	-81.3
e) Current Account balance (Not NIPA)	-136.4	-101.8
f) Net change in foreign indebtedness (Net foreign investment)	-143.6	-100.8

* To be determined. Government borrowing NIPA basis must be consistent with OMB budget projections.

The estimated direction and extent of the influence of Federal borrowing on interest rates and on the exchange value of the dollar is also required by the Act. Projections for interest rates are discussed elsewhere. The influence of Federal borrowing on exchange rates depends on many factors and most experts agree that no clear direct relationship can be deduced. Important factors are not only the magnitude of the variables displayed above, but also relative tax rates on capital investment, public perceptions of future monetary and fiscal policy, and the efforts of trading partners to reduce external imbalances and developing countries to implement structural reforms. Thus, T-2 proposes to discuss the issue and point out the large uncertainty involved with estimating such effects, as is true with estimating all of the projections displayed above.

Comparative Estimates

<u>Current Account Balance - \$ Billions</u>	<u>Fiscal Year Average</u>		
	<u>1988</u>	<u>1989</u>	<u>1990</u>
Data Resources, Inc. (Nov. 1988)	-136.9	-130.5	-107.9
Wharton (Nov. 1988)	-136.0	-133.2	-133.1
BEA (Oct. 1988)	-139.2	-136.6	-139.7
Merril Lynch (Oct. 1988)	-135.3	-122.7	NA
T-2 Recommendation	-136.4		-101.8
<u>Net Exports of Goods (nominal)</u>			
Data Resources, Inc. (Oct. 1988)	-133.8	-108.8	-82.8
Wharton (Oct. 1988)	-134.4	-118.8	-115.5
BEA (Oct. 1988)	-135.5	-110.8	-105.4
T-2 Recommendation	-135.5		-81.3

November 8, 1988

MEMORANDUM FOR T-1: Nicholas F. Brady, Treasury
Beryl W. Sprinkel, CEA
Joseph R. Wright, OMB

FROM: T-2: Michael R. Darby, Treasury
Allan H. Meltzer, CEA
John C. Weicher, OMB

SUBJECT: Revision of Administration Economic Assumptions
for the FY1990 Budget

To prepare for projections of the Federal budget for FY1990, T-1 must soon decide on revisions of the Administration's economic assumptions to recommend to the President. The date for public release of the revised assumptions must also be determined, in line with a schedule consistent with publication of the Budget document in early 1989.

Revisions to the Administration's assumptions are required to take account of developments since the preparation of the Mid-Session forecast. The economic effects of the drought are larger than previously anticipated; this affects real GNP growth in both 1988 and 1989. Oil prices have declined and are expected to decline somewhat further in the near term. Long-term and, particularly, short-term interest rates have risen in contrast to the declines forecast in the Mid-Session projections. Adjustments to the Administration's previous projections to take account of these factors are essentially viewed as mid-course corrections and are not seen as affecting projections of the underlying long-term expansion path of the economy.

Recommendations for revisions in the Administration's economic assumptions have been prepared by T-2 and are compared with the Mid-Session assumptions in Table 1 attached. To reflect the effects of the drought, T-2 recommends reducing the forecast for real GNP growth from 3.0 to 2.5 percent (fourth quarter to fourth quarter) in 1988. All of the effects of the drought on economic growth are reversed in 1989, but our estimates for 1989 also reflect an expectation of somewhat slower growth in the nonfarm sectors of the economy than previously assumed. The combined effect of these adjustments raises the forecast for 1989 from 3.3 percent to 3.5 percent

(fourth quarter to fourth quarter). Slight increases in GNP growth in 1990 and 1991 are recommended to compensate for downward revisions to growth in 1988 and 1989 while maintaining the underlying growth rate unchanged. The adjustments keep the average rate of growth over the full projection period at the level established in both the Mid-Session and January 1988 Budget projections.

Only two revisions are recommended for inflation rates: an upward revision to the GNP deflator from 3.5 to 3.9 percent in 1988 to reflect slightly higher-than-expected increases so far this year, and a downward revision from 3.9 to 3.7 percent for the CPI in 1989, partly to take into account lower anticipated oil prices. Projections of short- and long-term interest rates for 1988 and 1989 are revised upward to reflect what has occurred since the Mid-Session projections. The projected increases are less than increases in market interest rates since February. Projected slower real growth in nonfarm sectors of the economy during 1989, and lowered expectations of inflation, partly the result of lower oil prices, are assumed to relieve part of the recent upward pressure on interest rates. (Long rates are now below their August highs.)

Real GNP Growth and the Unemployment Rate

The downward revision to real GNP growth in 1988 is more than explained by the estimated 0.7 percent negative impact on GNP growth for the year resulting from the effects of the drought on farm output and inventories. (Our projection of 1.5 percent real GNP growth in the fourth quarter of 1988 reflects a 1.5 percentage point loss to growth due to the drought.) The drought-related loss to GNP is offset somewhat by slightly stronger-than-expected growth elsewhere in the economy during the year; this accounts for the less than 0.7 percent downward revision to 1988 growth relative to our previous projections.

The upward revision to GNP growth in 1989 reflects a 0.7 percentage point rebound in growth due to the end of the drought, partly offset by some lowering of expectations for growth in the nonfarm sectors of the economy. Slower growth in the nonfarm sectors in part reflects the tightening of monetary policy during 1988. In line with growth in recent months, the pace of real consumer purchases is expected to continue to slow from the fast pace of the first three quarters of this year. Also, it is our assessment that the rate of growth in real business fixed investment and in real net exports experienced in 1988 will moderate somewhat next year.

As indicated in Table 2 (attached), the Blue Chip consensus forecast for real GNP growth published October 10 (to be updated November 9) projects 2.0 percent growth in 1989, 1.5 percentage points below our recommendation of 3.5 percent. However, it appears that their projections do not totally

reflect the effects of the drought and are likely to be raised in coming months. Excluding drought effects, our recommendation is estimated to be about 0.5 to 1.0 percentage point above the consensus.

One member of T-2 has proposed an alternative path for real GNP growth. This path is shown as "T-2 Alternative" in Table 1. The main difference between "T-2" and "T-2 Alternative" is that 1989 growth is 3.9 instead of 3.5 percent.

It is the view of T-2 that the revised growth pattern outlined above for 1988 and 1989 does not materially affect the longer term growth potential of the U.S. economy. Thus, slight upward revisions to growth of 0.1 and 0.2 percentage points are recommended for 1990 and 1991 respectively, to offset the accumulated decreases for 1988 and 1989 relative to our previous forecast. This adjustment will hold the average for real GNP growth to approximately 3.2 percent, the same as in the Mid-Session and January 1988 Budget projections.

Since most of the revisions to the GNP projections are drought related and are assumed to have little effect on employment, T-2 recommends no change to the rates of unemployment established in the Mid-Session Review.

Inflation Rates

So far this year, prices have risen at a slightly faster pace than previously projected, owing partly to the effects of the drought on food prices. The recommended upward revision to the GNP deflator for 1988 embodies price increases that have already occurred.

The CPI also reacted to food price increases in 1988 and will begin to reflect lower oil prices in 1989. The average refiner's acquisition cost of oil is currently close to \$14 a barrel, down from an average of \$15.7 in the first half of the year and is expected to fall further. The GNP deflator, which is only indirectly affected by foreign crude oil prices is unrevised for 1989.

Interest Rates

Owing to stronger-than-expected growth this year, rising inflation expectations, and tightened Fed policy, interest rates continued to rise since the Mid-Session forecast rather than fall as previously projected. T-2 recommends that the annual rate for 10-year and 91-day Treasuries be revised up to reflect the recent experience but that the upward revisions be reduced in later years in order to return to the Mid-Session assumptions by 1991 or 1992 and in later years. The decline in rates from current levels, projected for 1989, indicates a belief that recent accelerated price increases are temporary

and inflation expectations will continue to decline as they have since August. (Declining oil prices will reinforce this development.) Our interest rate projections also reflect the assumption that the nonfarm economy will slow somewhat next year from this year's pace. After peaking in August, long rates have been declining but have not yet reached the values projected in the Mid-Session Review.

Policy Assumptions

As always, the Administration's economic projections are conditional on critical assumptions about economic policy. T-2 assumes that monetary policy will continue to support sustainable economic growth, while the Federal Reserve gradually pursues the long-term objective of price stability. Fiscal policy is assumed to achieve roughly the deficit reduction objectives of the Gramm-Rudman-Hollings Act through economic growth and spending restraint and without an increase in tax rates.

Attachments

TABLE 1

Fourth Quarter to Fourth Quarter Growth Rates

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
Real GNP								
Mid-Session Review	4.0	3.0	3.3	3.3	3.2	3.2	3.2	
T-2 Recommendation	5.0	2.5	3.5	3.4	3.4	3.2	3.2	3.2
T-2 Alternative	5.0	2.6	3.9	3.4	3.4	3.2	3.2	3.2
GNP Implicit Deflator								
Mid-Session Review	3.3	3.5	3.7	3.5	3.0	2.5	2.0	
T-2 Recommendation	3.1	3.9	3.7	3.5	3.0	2.5	2.0	1.5
T-2 Alternative			(Same as T-2 Recommendation)					
CPI - All Urban								
Mid-Session Review	4.5	4.3	3.9	3.5	3.0	2.5	2.0	
T-2 Recommendation	4.5	4.3	3.7	3.5	3.0	2.5	2.0	1.5
T-2 Alternative			(Same as T-2 Recommendation)					

Levels (Annual Average)

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
3-Month T-Bill Rate								
Mid-Session Review	5.8	6.0	5.5	5.0	4.5	4.0	3.5	
T-2 Recommendation	5.8	6.6	6.3	5.5	4.5	4.0	3.5	3.0
T-2 Alternative			(Same as T-2 Recommendation)					
10-Year T-Bill Rate								
Mid-Session Review	8.4	8.5	8.1	7.1	6.0	5.0	4.5	
T-2 Recommendation	8.4	8.8	8.3	7.5	6.5	5.5	4.5	4.0
T-2 Alternative			(Same as T-2 Recommendation)					
Total Unemployment Rate								
Mid-Session Review	6.1	5.5	5.2	5.1	5.0	5.0	5.0	
T-2 Recommendation	6.1	5.4	5.2	5.1	5.0	5.0	5.0	5.0
T-2 Alternative			(Same as T-2 Recommendation)					

TABLE 2

Comparison of Short Term Economic Forecasts

	Percent Change (4Qtr to 4Qtr)			Percent (average for year)	
Real GNP -----	1988	1989	Civilian Unemployment Rate (2) -----	1988	1989
Data Resources, Inc. (Nov.1988)	2.5	2.0	Data Resources, Inc.	5.5	5.6
Wharton (Nov.1988)	2.7	2.4	Wharton	5.5	5.5
L.H.Meyer & Assoc. (Nov.1988)	2.5	2.9	L.H.Meyer & Assoc.	5.5	5.4
Blue Chip Consensus (Oct.1988)	3.0	2.0	Blue Chip Consensus	5.5	5.5
CBO (Aug.1988)	2.6	2.7	CBO	5.5	5.5
Mid-Session Forecast (Jun.1988)	3.0	3.3	Mid-Session Forecast	5.6	5.3
T-2 Recommendation (Nov.1988)	2.5	3.5	T-2 Recommendation	5.5	5.3
Consumer Price Index - Urban -----			3-Mo. Treasury Bill Rate -----		
Data Resources, Inc.	4.2	4.7	Data Resources, Inc.	6.6	7.5
Wharton	4.1	4.7	Wharton	6.6	7.7
L.H.Meyer & Assoc.	4.2	4.7	L.H.Meyer & Assoc.	6.6	7.0
Blue Chip Consensus	4.3	4.8	Blue Chip Consensus	6.6	7.2
CBO (1)	4.4	5.0	CBO	6.3	7.1
Mid-Session Forecast	4.3	3.9	Mid-Session Forecast	6.0	5.5
T-2 Recommendation	4.3	3.7	T-2 Recommendation	6.6	6.3
GNP Deflator -----			10-Yr. Treasury Bond rate -----		
Data Resources, Inc.	3.7	3.7	Data Resources, Inc.	8.8	9.1
Wharton	4.0	4.6	Wharton	8.8	9.7
L.H.Meyer & Assoc.	4.0	3.4	L.H.Meyer & Assoc.	8.8	8.7
Blue Chip Consensus	3.9	4.4	Blue Chip Consensus	NA	NA
CBO	3.6	4.2	CBO	8.9	9.1
Mid-Session Forecast	3.5	3.7	Mid-Session Forecast	8.5	8.1
T-2 Recommendation	3.9	3.7	T-2 Recommendation	8.8	8.3

(1) CPI-W

(2) Recommendation to the President is for the Total Unemployment Rate, which is generally 0.1 percentage points below the Civilian Unemployment Rate.

P R E L I M I N A R Y D R A F T

November 8, 1988
APPENDIX TO T-2 MEMO

The 1988 Omnibus Trade Bill requires that OMB, after consultation with the Chairman of the Council of Economic Advisers, include a "Federal Budget Competitiveness Impact Statement" in the annual Budget document. The Bill calls for projections for the year of the budget only -- FY1990. The following table lists the categories for which numerical values are requested and shows suggested projections consistent with the T-2 recommended path. ~~(Projections for FY1989 are provided for perspective only and will not be published.)~~

	FY88 (current dollars)	FY90
a) Amount of borrowing by the Federal Government in private credit markets	143.8	84.8
b) Net domestic savings, including personal savings, corporate savings, and fiscal surplus of state and local governments	770.7	861.1
c) Net private domestic investment	263.0	312.1
d) Merchandise trade account (net exports of goods)	-135.3	-81.3
e) Current Account balance	-136.4	-101.8
f) Net change in foreign indebtedness (Net foreign investment)	-143.6	100.8

The decline in net foreign investment reflects the trend toward larger national saving embodied in these figures. The projected decline in Federal dissaving consistent with the Gramm-Rudman-Hollings targets, coupled with an improving private savings balance, increases domestic credit available for investment and lowers the amount from foreign sources. Lower net foreign investment implies improving current and merchandise accounts.

The estimated direction and extent of the influence of Federal borrowing on interest rates and on the exchange value of the dollar is also required by the Act. Projections for interest rates are discussed elsewhere. The influence of Federal borrowing on exchange rates depends on many factors and most experts agree that no clear direct relationship can be deduced. Important factors are not only the magnitude of the variables displayed above, but also public perceptions of future monetary and fiscal policy, and the efforts of trading partners to reduce external imbalances and developing countries to implement structural reforms. Thus, T-2 proposes to discuss the issue and point out the large uncertainty involved with estimating such effects, as is true with estimating all of the projections displayed above.

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EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

April 23, 1987

MEMORANDUM FOR T1: JAMES A. BAKER, III
JAMES C. MILLER III
BERYL W. SPRINKEL ✓

FROM: T2: MICHAEL DARBY *Stephen Enten for M.D.*
KATHRYN EICKHOFF *Kathryn Eickhoff*
MICHAEL MUSSA *Michael Mussa*

SUBJECT: Budget Offsets from Productivity Improvements -
Deregulation of Natural Gas

To provide budget offsets for tax subsidies for domestic energy exploration and development, the Department of Energy proposes to count the estimated increase in general tax revenues resulting from the economic efficiency gain generated by natural gas deregulation. Specifically, DOE would like to count an estimated annual revenue gain of about \$300 million associated with a projected \$1.5 billion annual economic efficiency gain due to natural gas deregulation.

T-2 strongly recommends that this budget offset proposed by DOE not be allowed. The economic forecast and projections that underlie the President's budget already assume a substantial improvement in productivity growth, from a 1.1 percent annual rate over the last 5 years to a 1.9 percent annual rate over the next 5 years. This projected strengthening of productivity growth and the associated strengthening of general economic growth are predicated on adoption of the President's proposals to improve productivity and economic efficiency, including his long-standing proposals to deregulate natural gas. Thus, the favorable effects of natural gas deregulation are already incorporated in the forecast of future economic performance and in the revenues that are associated with this forecast.

Moreover, allowing this particular budget offset would open the flood gates to claims of budget offsets from other already-proposed initiatives to improve the performance of the economy. The threat to budget discipline from establishing this precedent would exist not only in the Administration, but most especially in the Congress.

The discussion of the Administration's economic forecast and projections in the 1987 Economic Report of the President makes clear the assumptions that underlie the revenue projections that appear in the budget. (See Appendix.)

The favorable economic effects of natural gas deregulation are not analyzed separately and explicitly in the Economic Report of the President or in the Budget, but neither are the favorable effects of other Administration proposals to improve productivity and economic efficiency. Rather, these effects are subsumed in the general assumption of stronger productivity growth -- a rate of productivity growth that is substantially above that assumed by many other economic forecasters including the Congressional Budget Office. Allowance of an additional budget offset for the favorable economic effect of natural gas deregulation would clearly be double counting, and would perhaps invite double counting of the prospective revenue benefits of other Administration proposals.

APPENDIX

(Excerpts from the 1987 Economic Report of the President.)

The Administration's longer term economic projections ... reflect the long-run economic policy goals of the Administration and long-run trends in the economy. Specifically, it is assumed that the incentives for economic activity embodied in the reduced marginal tax rates contained in the Tax Reform Act of 1986 are preserved and that further gains are made in reducing government spending and the burden of government regulation. (Emphasis added. Page 60.)

Specifically, the Administration's economic projections detailed in Table 1-5 show real GNP growth rising to 3.6 percent in 1989 and declining slowly to 3.4 percent in 1992. Stronger real growth reflects the long-term benefits of tax reform, as well as factors that will improve growth in the current year and carry forward in later years.... Productivity growth is projected to improve from recent levels because of the normal cyclical effect of stronger output growth and because of expected improvements (discussed earlier) in the trend rate of growth of labor productivity. (Pages 60-61.)

Productivity can be promoted by avoiding policies that inhibit the efficient functioning of private businesses and competitive markets.... Government can also contribute to stronger productivity growth by eliminating or reducing burdensome and inappropriate regulation. (Page 49.)

AGENDA - T2 MEETING

- o Real GNP
- o Inflation
- o Employment/Unemployment rate
- o Interest Rates
- o Other variables?

Short Run

Mid Session Review

Real GNP Path

	<u>MSR</u>	<u>MSR Updated</u>	<u>A</u>	<u>B</u>	<u>C</u>
85III	4.5	4.3	4.3	4.3	4.3
IV	5.5	5.5	6.0	5.0	4.0
86I	4.0	4.0	6.0	5.0	5.0
II	4.0	4.0	5.0	4.0	5.0
III	4.0	4.0	3.0	3.0	3.0
IV	4.0	4.0	3.0	3.0	3.0
IV/IV 86	4.0	4.0	4.2	3.7	4
1986/85	4.0	4.2	4.8	4.1	4.1
1986IV level	1780.4	1780.1	1786.4	1773.7	1773.7

Inflation Path - GNP Deflator

	<u>MSR</u>	<u>MSR Updated</u>	<u>A</u>	<u>B</u>
85III	4.0	2.3	2.3	2.3
IV	4.0	4.0	3.0	4.0
86I	4.3	4.3	3.0	5.0
II	4.3	4.3	3.0	5.0
III	4.3	4.3	3.0	5.0
IV	4.3	4.3	3.0	5.0
IV/IV 86	4.3	4.3	3.0	5.0
1986/85	4.3	3.9	2.9	4.5
1986IV level	245.2	231.1	240.5	246.4

Unemployment Rate - Total

	<u>MSR</u>	<u>MSR Updated</u>
85III	7.1	S
IV	7.0	
I	6.9	A
II	6.9	
III	6.8	M
IV	6.8	E

Interest Rates91-Day Bill Rate

	<u>MSR</u>	<u>MSR Updated</u>	<u>Futures</u>
85III	7.2	7.1	7.1
IV	7.5		7.1
86I	7.5		7.1
II	7.5		7.3
III	7.5		7.6
IV	7.4		7.9

10-Year Treasury

	<u>MSR</u>	<u>MSR Updated</u>	<u>Futures</u>
85III	10.5	10.3	10.3
IV	10.3		10.3
86I	10.2		10.4
II	10.1		10.6
III	9.8		10.7
IV	9.7		10.8

Long Run

Real GNP - % Change IV/IV

	<u>MSR</u>	<u>MSR Updated</u>
85	3.0	S
86	4.0	
87	4.0	A
88	4.0	
89	3.8	M
90	3.6	
91	NA	E

Inflation - % Change IV/IV in GNP deflator

	<u>MSR</u>	<u>MSR Updated</u>
85	4.0	3.6
86	4.3	
87	4.1	
88	3.8	
89	3.5	
90	3.2	
91	NA	

Unemployment Rate - Total (annual average)

	<u>MSR</u>	<u>MSR Updated</u>
85	7.1	S
86	6.8	
87	6.6	A
88	6.3	
89	6.1	M
90	5.8	
91	NA	E

Interest Rates (annual Average)

91-Day Bill Rate

	<u>MSR</u>	<u>Real Rate</u>
85	7.6	3.8
86	7.5	3.4
87	7.0	2.8
88	5.9	2.0
89	5.1	1.5
90	5.0	1.7
91	NA	NA

10-Year Treasury

	<u>MSR</u>	<u>Real Rate</u>
85	10.8	7.0
86	9.9	5.8
87	9.0	4.8
88	7.3	3.4
89	5.7	2.1
90	5.5	2.2
91	NA	NA

LR

hold 86427+pl

1. Read $\leftarrow$
2. In $\leftarrow$ at zero; 1st 1st
3. Read int $\leftarrow$
4. Unempl 9/5.6 $\leftarrow$

Other:

If do int $\leftarrow$ 6 clear
Re Budm passes

Cycle rate: Take
latest no

Oil Res: Alternating
3. Will get
one of zero
 $\leftarrow$ by 1/2 Kelly
see ahead

1. Buyers not down but
chase up $\Rightarrow$ net loss
in nominels.

~~2. 4 to 5~~

2. 4 to 5 $\Rightarrow$ perhaps 5 to 4.5; 3 to 3.5

3. 4 to 5 3.5 to 4 in 9 / MS & MJ
Kathy - not credible

AGENDA - T2 MEETING

- o Real GNP
- o Inflation
- o Employment/Unemployment rate
- o Interest Rates
- o Other variables?

Short Run

Real GNP Path

	<u>MSR</u>	<u>MSR Updated</u>	<u>A</u>	<u>B</u>	<u>C</u>
85III	4.5	4.3	4.3	4.3	4.3
IV	5.5	5.5	6.0	5.0	4.0
86I	4.0	4.0	6.0	5.0	5.0 4.5
II	4.0	4.0	5.0	4.0	5.0 4.5
III	4.0	4.0	3.0	3.0	3.0 3.5
IV	4.0	4.0	3.0	3.0	3.0 3.5
IV/IV 86	4.0	4.0	4.2	3.7	4
1986/85	4.0	4.2	4.8	4.1	4.1
1986IV level	1780.4	1780.1	1786.4	1773.7	1773.7

Inflation Path - GNP Deflator

	<u>MSR</u>	<u>MSR Updated</u>	<u>A</u>	<u>B</u>
85III	4.0	2.3	2.3	2.3
IV	4.0	4.0 3.1	3.0	4.0
86I	4.3	4.3 3.4	3.0	5.0
II	4.3	4.3 3.8	3.0	5.0
III	4.3	4.3 4.2	3.0	5.0
IV	4.3	4.3 4.5	3.0	5.0
IV/IV 86	4.3	4.3	3.0	5.0
1986/85	4.3	3.9	2.9	4.5
1986IV level	245.2	231.1	240.5	246.4

Unemployment Rate - Total

	<u>MSR</u>	<u>MSR Updated</u>
85III	7.1	S
IV	7.0	
I	6.9	A
II	6.9	
III	6.8	M
IV	6.8	E

Interest Rates91-Day Bill Rate

	<u>MSR</u>	<u>MSR Updated</u>	<u>Futures</u>
85III	7.2	7.1	7.1
IV	7.5		7.1
86I	7.5		7.1
II	7.5		7.3
III	7.5		7.6
IV	7.4		7.9

10-Year Treasury

	<u>MSR</u>	<u>MSR Updated</u>	<u>Futures</u>
85III	10.5	10.3	10.3
IV	10.3		10.3
86I	10.2		10.4
II	10.1		10.6
III	9.8		10.7
IV	9.7		10.8

Long Run

Real GNP - % Change IV/IV

	<u>MSR</u>	<u>MSR Updated</u>
85	3.0	S
86	4.0	
87	4.0	A
88	4.0	
89	3.8	M
90	3.6	
91	NA	E

Inflation - % Change IV/IV in GNP deflator

	<u>MSR</u>	<u>MSR Updated</u>
85	4.0	3.6
86	4.3	
87	4.1	
88	3.8	
89	3.5	
90	3.2	
91	NA	

Unemployment Rate - Total (annual average)

	<u>MSR</u>	<u>MSR Updated</u>
85	7.1	S
86	6.8	
87	6.6	A
88	6.3	
89	6.1	M
90	5.8	
91	NA	E

Interest Rates (annual Average)

91-Day Bill Rate

	<u>MSR</u>	<u>Real Rate</u>
85	7.6	3.8
86	7.5	3.4
87	7.0	2.8
88	5.9	2.0
89	5.1	1.5
90	5.0	1.7
91	NA	NA

10-Year Treasury

	<u>MSR</u>	<u>Real Rate</u>
85	10.8	7.0
86	9.9	5.8
87	9.0	4.8
88	7.3	3.4
89	5.7	2.1
90	5.5	2.2
91	NA	NA

OMB estimate of the impact of reducing Inflation to zero in
1988. Real Growth and real interest rates constant.

Change in:

	<u>Receipts</u>	<u>Outlays</u>	<u>Deficit</u>
1986	- 3.9	-4.3	+0.4
1987	-26.3	-32.4	+6.2
1988	-62.2	-64.9	+2.7
1989	-103.7	-99.9	-3.8
1990	-146.3	-139.8	-6.5

RATES OF CHANGE: PROJECTIONS
1985-1990 based on midsession economic assumptions

DATE	TOTAL CIVILIAN POPULTN OVER 16	CIVILIAN LABOR FORCE PARTCPTN RATE	CIVILIAN EMPLYMT RATE (as % of labor force)	TOTAL CIVILIAN EMPLYMT (bls)	RATIO OF CIVILIAN EMPLOYMT /PAYROLL EMPLOYMT (%)	TOTAL EMPLOYEES PRIVATE NONFARM PAYROLLS (bls)	AVERAGE HOURS NONFARM BUS. SECTOR (bls)	TOTAL HOURS NONFARM BUSINESS SECTOR (bls)	OUTPUT/ HOUR NONFARM BUSINESS SECTOR (bls)	NONFARM BUSINESS OUTPUT LESS HOUSING (nipa)	RATIO OF NONFARM BUSINESS OUTPUT TO REAL GNP (%)	REAL GNP (nipa)	REAL GNP/ CAPITA
1985	1.34	0.57	0.27	2.19	1.75	3.98	-1.42	2.50	0.60	3.30	0.56	2.72	1.37
1986	1.12	0.77	0.33	2.24	0.09	2.33	0.07	2.40	2.30	4.60	0.39	4.20	3.05
1987	1.10	0.51	0.30	1.91	1.27	3.21	-0.49	2.70	1.70	4.40	0.38	4.00	2.87
1988	0.92	0.82	0.30	2.06	0.71	2.78	-0.37	2.40	2.10	4.50	0.49	3.99	3.04
1989	0.82	0.57	0.27	1.67	0.69	2.37	-0.26	2.10	2.60	4.20	0.30	3.88	3.03
1990	0.76	0.45	0.25	1.47	0.43	1.90	-0.19	1.70	2.80	3.90	0.27	3.62	2.84
1991	0.76	0.52	0.16	1.44	NA	NA	NA	NA	NA	NA	NA	3.40	2.62
1985-90	0.94	0.62	0.29	1.87	0.64	2.52	-0.25	2.26	2.30	4.32	0.37	3.94	2.97
1948-84	1.51	0.25	-0.10	1.66	0.30	1.98	-0.44	1.42	2.02	3.47	.00	3.45	1.92

RATES OF CHANGE: PROJECTIONS
1985-1990 based on EP October forecast

DATE	TOTAL CIVILIAN POPULTN OVER 16	CIVILIAN LABOR FORCE PARTCPTN RATE	CIVILIAN EMPLYMT RATE (as % of labor force)	TOTAL CIVILIAN EMPLYMT (bls)	RATIO OF CIVILIAN EMPLOYMT /PAYROLL EMPLOYMT (%)	TOTAL EMPLOYEES PRIVATE NONFARM PAYROLLS (bls)	AVERAGE HOURS NONFARM BUS. SECTOR (bls)	TOTAL HOURS NONFARM BUSINESS SECTOR (bls)	OUTPUT/ HOUR NONFARM BUSINESS SECTOR (bls)	NONFARM BUSINESS OUTPUT LESS HOUSING (nipa)	RATIO OF NONFARM BUSINESS OUTPUT TO REAL GNP (%)	REAL GNP (nipa)	REAL GNP/ CAPITA
1985	1.34	0.50	0.32	2.17	1.58	3.78	-0.92	2.82	0.20	2.65	0.19	2.45	1.10
1986	1.12	0.72	0.10	1.95	0.38	2.34	-0.90	1.42	1.42	3.23	-0.15	3.38	2.24
1987	1.10	0.73	0.38	2.22	0.32	2.55	0.16	2.71	1.29	4.04	0.43	3.59	2.47
1988	0.92	0.69	0.21	1.84	0.30	2.15	0.23	2.38	1.41	3.82	0.38	3.43	2.48
1989	0.82	0.66	-0.01	1.48	0.30	1.78	0.31	2.10	1.25	3.29	0.25	3.03	2.19
1990	0.76	0.68	0.24	1.69	-0.03	1.66	0.20	1.86	1.47	3.36	0.31	3.04	2.26
1991	0.76	0.67	0.24	1.68	-0.34	1.34	0.12	1.46	1.32	2.80	0.24	2.55	1.78
1985-90	0.94	0.69	0.19	1.84	0.26	2.10	.00	2.09	1.37	3.55	0.25	3.29	2.33
1948-84	1.51	0.25	-0.10	1.66	0.30	1.98	-0.44	1.42	2.02	3.47	.00	3.45	1.92

RATES OF CHANGE: SUMMARY

PERIOD	TOTAL CIVILIAN POPULTN OVER 16	CIVILIAN LABOR FORCE PARTCPTN RATE	CIVILIAN EMPLYMT RATE (as % of labor force)	TOTAL CIVILIAN EMPLYMT (bls)	RATIO OF CIVILIAN EMPLOYMT /PAYROLL EMPLOYMT (%)	TOTAL EMPLOYEES PRIVATE NONFARM PAYROLLS (bls)	AVERAGE HOURS NONFARM BUS. SECTOR (bls)	TOTAL HOURS NONFARM BUSINESS SECTOR (bls)	OUTPUT/ HOUR NONFARM BUSINESS SECTOR (bls)	NONFARM BUSINESS OUTRUT LESS HOUSING (nipa)	RATIO NONFARM BUSINESS OUTPUT TO REAL GNP (%)	REAL GNP (nipa)
*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****
1948-84	1.51	0.25	-0.10	1.66	0.30	1.98	-0.44	1.42	2.02	3.47	.00	3.45
1948-53	0.76	0.01	0.18	0.96	1.17	2.17	-0.64	1.51	2.77	4.34	-0.64	4.99
1953-57	1.20	0.32	-0.34	1.17	-0.19	0.99	-0.29	0.70	1.82	2.55	0.15	2.37
1957-60	1.46	-0.12	-0.43	0.90	-0.43	0.49	-0.20	0.30	2.19	2.45	-0.15	2.57
1960-69	1.52	0.12	0.24	1.90	0.78	2.70	-0.47	1.91	2.67	4.60	0.17	4.42
1969-73	2.30	0.29	-0.35	2.24	-0.19	2.05	-0.48	1.40	2.48	3.91	0.22	3.66
1973-79	1.92	0.77	-0.16	2.55	0.14	2.71	-0.59	2.10	0.69	2.82	-0.04	2.83
1973-81	1.84	0.63	-0.36	2.11	0.12	2.24	-0.59	1.58	0.60	2.19	-0.23	2.40
1981-84	1.21	0.25	0.06	1.53	-0.04	1.51	0.04	1.48	2.13	3.70	0.85	2.79

LEVELS: PROJECTIONS

1985-1990 based on midsession economic assumptions

DATE	TOTAL CIVILIAN POPULTN OVER 16	CIVILIAN LABOR FORCE PARTCPTN RATE	CIVILIAN EMPLYMT RATE (as % of labor force)	TOTAL CIVILIAN EMPLYMT (bls)	RATIO OF CIVILIAN EMPLOYMT /PAYROLL EMPLOYMT (%)	TOTAL EMPLOYEES PRIVATE NONFARM PAYROLLS (bls)	AVERAGE HOURS NONFARM BUS. SECTOR (bls)	TOTAL HOURS NONFARM BUSINESS SECTOR (bls)	OUTPUT/ HOUR NONFARM BUSINESS SECTOR (bls)	NONFARM BUSINESS OUTPUT LESS HOUSING (nipa)	RATIO OF NONFARM BUSINESS OUTPUT TO REAL GNP (%)	REAL GNP (nipa)
1985	178210	64.9	92.7	107300	76.0	81600	35.0	116.54	106.89	1269.4	75.4	1683.9
1986	180200	65.4	93.0	109700	76.1	83500	35.1	119.34	109.35	1327.7	75.7	1754.6
1987	182175	65.8	93.3	111800	77.1	86180	35.0	122.56	111.20	1386.2	76.0	1824.8
1988	183860	66.3	93.6	114100	77.6	88580	34.9	125.50	113.54	1448.5	76.3	1897.6
1989	185380	66.7	93.9	116000	78.2	90680	34.9	128.14	116.49	1509.4	76.6	1971.3
1990	186790	67.0	94.1	117700	78.5	92400	34.9	130.32	119.75	1568.2	76.8	2042.7
1991	188210	67.3	94.2	119400	NA	NA	NA	NA	NA	NA	NA	2112.2

RATES OF CHANGE: PROJECTIONS

1985-1990 based on midsession economic assumptions

DATE	TOTAL CIVILIAN POPULTN OVER 16	CIVILIAN LABOR FORCE PARTCPTN RATE	CIVILIAN EMPLYMT RATE (as % of labor force)	TOTAL CIVILIAN EMPLYMT (bls)	RATIO OF CIVILIAN EMPLOYMT /PAYROLL EMPLOYMT (%)	TOTAL EMPLOYEES PRIVATE NONFARM PAYROLLS (bls)	AVERAGE HOURS NONFARM BUS. SECTOR (bls)	TOTAL HOURS NONFARM BUSINESS SECTOR (bls)	OUTPUT/ HOUR NONFARM BUSINESS SECTOR (bls)	NONFARM BUSINESS OUTPUT LESS HOUSING (nipa)	RATIO OF NONFARM BUSINESS OUTPUT TO REAL GNP (%)	REAL GNP (nipa)
1985	1.04	0.86	0.27	2.19	1.75	3.98	-0.78	2.50	0.60	3.30	0.56	2.72
1986	1.12	0.78	0.33	2.24	0.09	2.33	0.29	2.40	2.30	4.60	0.39	4.20
1987	1.10	0.51	0.30	1.91	1.27	3.21	-0.28	2.70	1.70	4.40	0.38	4.00
1988	0.92	0.82	0.30	2.06	0.71	2.78	-0.29	2.40	2.10	4.50	0.49	3.99
1989	0.83	0.56	0.27	1.67	0.69	2.37	0.00	2.10	2.60	4.20	0.30	3.88
1990	0.76	0.45	0.25	1.47	0.43	1.90	0.00	1.70	2.80	3.90	0.27	3.62
1991	0.76	0.51	0.16	1.44	NA	NA	NA	NA	NA	NA	NA	3.40
1986-90	0.94	0.62	0.29	1.87	0.64	2.52	-0.06	2.26	2.30	4.32	0.37	3.94
1948-84	1.51	0.25	-0.10	1.66	0.30	1.98	-0.44	1.42	2.02	3.47	.00	3.45

LEVELS

DATE	TOTAL CIVILIAN POPULTN OVER 16	CIVILIAN LABOR FORCE PARTCPTN RATE	CIVILIAN EMPLYMT RATE (as % of labor force)	TOTAL CIVILIAN EMPLYMT (bls)	RATIO OF TOTAL CIVILIAN EMPLOYMT /PAYROLL EMPLYMT (%)	TOTAL PRIVATE NONFARM PAYROLLS (bls)	AVERAGE HOURS NONFARM BUS. SECTOR (bls)	TOTAL HOURS NONFARM BUSINESS SECTOR (bls)	OUTPUT/ HOUR NONFARM BUSINESS SECTOR (bls)	NONFARM BUSINESS OUTPUT LESS HOUSING (nipa)	RATIO NONFARM BUSINESS OUTPUT TO REAL GNP (%)	REAL GNP (nipa)
****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****	*****
1948	103068	58.8	96.2	58358	67.2	39216	41.3	69.38	51.93	367.7	75.1	489.8
1949	103994	59.0	94.0	57683	65.7	37897	41.1	66.73	53.03	360.3	73.2	492.2
1950	104996	59.2	94.8	58892	66.5	39170	41.0	68.80	56.23	394.5	73.8	534.8
1951	104622	59.2	96.7	59967	69.1	41430	40.6	72.03	57.18	420.3	72.5	579.4
1952	105229	59.1	97.0	60272	70.0	42185	40.3	72.78	58.50	434.5	72.3	600.8
1953	107055	58.9	97.1	61206	71.2	43556	40.0	74.60	59.48	453.1	72.7	623.6
1954	108321	58.8	94.4	60107	70.3	42238	39.9	72.10	60.33	443.6	72.0	616.1
1955	109683	59.2	95.6	62131	70.4	43727	40.1	75.05	62.70	480.6	73.1	657.5
1956	110954	60.0	95.9	63792	70.7	45091	39.8	76.93	62.88	494.2	73.6	671.6
1957	112265	59.6	95.7	64065	70.6	45239	39.5	76.58	63.90	499.7	73.1	683.8
1958	113724	59.5	93.2	63043	69.0	43483	39.4	73.38	65.50	489.7	71.9	680.9
1959	115330	59.3	94.5	64629	69.9	45186	39.6	76.63	67.63	528.8	73.3	721.7
1960	117245	59.4	94.4	65785	69.7	45836	39.3	77.13	68.18	536.1	72.7	737.2
1961	118770	59.3	93.3	65744	69.1	45404	39.2	76.25	70.23	545.4	72.1	756.6
1962	120153	58.8	94.5	66702	70.0	46660	39.0	77.93	72.75	577.0	72.1	800.3
1963	122416	58.7	94.4	67760	70.0	47429	38.8	78.80	75.08	602.2	72.3	832.5
1964	124485	58.7	94.8	69301	70.3	48686	38.7	80.65	78.05	640.6	73.1	876.4
1965	126513	58.8	95.5	71070	71.3	50689	38.7	83.68	80.40	685.1	73.7	929.3
1966	128058	59.2	96.2	72878	72.9	53116	38.6	86.48	82.40	726.0	73.7	984.8
1967	129873	59.6	96.2	74376	73.2	54413	38.0	86.70	83.98	740.9	73.3	1011.4
1968	132027	59.6	96.4	75913	73.8	56058	37.8	88.55	86.60	780.6	73.8	1058.1
1969	134334	60.1	96.5	77875	74.7	58189	37.7	91.35	86.38	802.8	73.8	1087.6
1970	137086	60.4	95.0	78669	74.1	58325	37.1	90.00	86.78	793.6	73.1	1085.6
1971	140216	60.2	94.0	79355	73.5	58331	36.9	89.68	89.60	816.7	72.8	1122.4
1972	144125	60.4	94.4	82135	73.5	60341	37.0	92.58	92.83	873.5	73.7	1185.9
1973	147097	60.8	95.1	85051	74.1	63058	37.0	96.45	95.23	933.9	74.5	1254.3
1974	150121	61.3	94.4	86803	73.8	64095	36.5	96.73	93.15	912.9	73.2	1246.3
1975	153153	61.2	91.5	85830	72.5	62259	36.1	92.88	94.85	892.1	72.4	1231.6
1976	156149	61.6	92.3	88753	72.7	64511	36.1	96.08	97.88	952.5	73.4	1298.2
1977	159033	62.2	93.0	92017	73.2	67344	36.0	99.95	100.05	1016.0	74.2	1369.7
1978	161911	63.2	93.9	96046	73.9	71026	35.8	105.00	100.63	1074.8	74.7	1438.6
1979	164864	63.7	94.2	98825	74.8	73876	35.7	108.93	99.13	1098.5	74.3	1479.4
1980	167746	63.8	92.8	99303	74.7	74166	35.3	108.15	98.45	1082.5	73.4	1475.0
1981	170130	63.9	92.4	100397	74.8	75126	35.2	109.00	99.78	1105.3	73.1	1512.2
1982	172271	64.0	90.3	99527	74.1	73729	34.8	105.95	100.00	1075.6	72.7	1480.0
1983	174215	64.0	90.4	100822	73.7	74330	35.0	107.53	103.43	1130.6	73.7	1534.7
1984	176383	64.4	92.5	105003	74.7	78477	35.3	113.70	106.25	1228.8	75.0	1639.3



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

November 25, 1985

MEMORANDUM TO: M. KATHRYN EICKHOFF
FROM: The Gnomes of BRD¹ (Norwood/Neyland) *DN KEN*
SUBJECT: Budget Implications of Adjusted Mid-Session Baseline and Four Alternatives

The attached budget hit sheets price out the four alternative economic scenarios Bob Anderson provided us late Friday evening relative to the adjusted Mid-Session baseline as described below. The hits are on a current services basis -- i.e., with inflation adjustments for pay raises and discretionary programs, since it would make little sense to hold nominal outlays fixed for outyear inflation rates of 5-1/2% in some cases and zero in others. In all cases (baseline and alternatives) we hold projected income shares (beyond 1985:III) constant at the Mid-Session shares of GNP; "realistic" reassessments of the implications of zero inflation vs. 5-1/2% are beyond our capacity for a fast week-end turn-around.

The baseline is conceptually the same as for the Fall Overview: we start with Mid-Session current services adjusted for the enacted 1986 civilian pay freeze and the Resolution defense levels, given the Mid-Session economic assumptions. This is then further adjusted for the 3rd quarter +45 day GNP report and lower 1986 inflation (attachment 1); this adjusted Mid-Session base is then used as the baseline against which the four alternative scenarios are assessed. Note that a) no COLA occurs for social security and related programs (SSI, Railroad Retirement, Veterans) if the CPI falls below 3%, and b) our pay raise (PATC) prediction equations intercept produces 2.0% annual pay raises when the GNP deflator falls to zero and stays there.

The bridge from Mid-Session current services to the adjusted Mid-Session baseline is as follows:

¹Tallish Gnomes, to be sure; that's why we're called "growth gnomes."

ADJUSTMENT FROM MID-SESSION CURRENT SERVICES
TO ADJUSTED MID-SESSION BASELINE
(fiscal years; in billions of dollars)

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>
Receipts:					
Mid-Session current services.....	780.1	851.6	938.7	1,016.3	1,094.7
Economic adjustments	<u>-7.8</u>	<u>-9.4</u>	<u>-9.8</u>	<u>-10.7</u>	<u>-11.6</u>
Adjusted MSR baseline	772.3	842.2	928.9	1,005.6	1,083.1
Outlays:					
Mid-Session current services.....	1,022.7	1,104.7	1,194.6	1,260.1	1,332.6
1986 civilian pay freeze.....	-1.1	-1.3	-1.3	-1.4	-1.4
Resolution defense levels.....	-27.5	-45.2	-64.6	-75.0	-87.4
Economic adjustments.	<u>-5.3</u>	<u>-12.4</u>	<u>-18.9</u>	<u>-23.7</u>	<u>-28.6</u>
Adjusted MSR baseline	988.8	1,045.8	1,109.8	1,160.0	1,215.2
Deficit:					
Mid-Session current services.....	242.6	253.1	255.9	243.8	237.9
Adjustments.....	<u>-26.1</u>	<u>-49.5</u>	<u>-75.0</u>	<u>-89.3</u>	<u>-105.8</u>
Adjusted MSR baseline	216.5	203.6	180.9	154.5	132.1

← 1) debt service on above
2) outlays Δ from page 3

Attachments

Forecast Inventory Binder
Vol. V, Tab P, Item 1

cc: Mr. Modlin
Mr. Mathiasen
Mr. Al-Samarrie
Ms. Rodriguez
Mr. Wasserman
Mr. Anderson

237.9
- 87.4
19.0 *debt*
130.1
+ 2.0 *decon.*

Baseline

ESTIMATED BUDGET EFFECTS
 (113) MSR W/ +45 DAY 85:3 & LOWER 1986 INFLATION
 COMPARED TO (077) MID-SESSION REVIEW
 (FISCAL YEARS; BILLIONS OF DOLLARS)

COMPONENTS OF CHANGE	1984	1985	1986	1987	1988	1989	1990
BASE CASE RECEIPTS.....	666.5	734.0	780.1	851.6	938.7	1016.3	1094.7
INCOME TAXES:							
INDIVIDUAL - INCOMES.....	0.0	0.0	-4.9	-6.2	-6.8	-7.4	-8.0
INDIVIDUAL - INDEXATION..	0.0	0.0	0.1	1.3	2.0	2.2	2.3
CORPORATE.....	0.0	0.0	-0.3	-1.3	-1.4	-1.6	-1.6
PAYROLL TAXES:							
SOCIAL SECURITY & OTHER..	0.0	0.0	-2.6	-3.2	-3.5	-3.8	-4.1
UNEMPLOYMENT.....	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0
WINDFALL PROFIT TAXES.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER EXCISE TAXES.....	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
FRB DEPOSITS OF EARNINGS...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER RECEIPTS.....	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0
TOTAL RECEIPT CHANGES....	0.0	0.0	-7.3	-9.4	-9.8	-10.7	-11.6
ALTERNATE CASE RECEIPTS....	666.5	734.0	772.3	842.2	928.9	1005.6	1033.1
BASE CASE OUTLAYS.....	851.8	946.1	992.5	1052.8	1118.4	1169.3	1224.8
UNEMPLOYMENT SENSITIVE:							
UI PROGRAM.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
AUTOMATIC COLAS:							
SOCIAL SECURITY.....	0.0	0.0	-0.7	-1.9	-2.5	-2.6	-2.6
OTHER INDEXED PROGRAMS...	0.0	0.0	-0.3	-1.0	-1.2	-1.2	-1.2
HEALTH ENTITL./AFDC INFLAT.	0.0	0.0	-0.5	-0.6	-0.7	-0.7	-0.3
DISCRETIONARY INFLATION:							
SPRO - OIL (OFF-BUDGET)..							
NONDEFENSE - OIL.....							
NONDEFENSE - OTHER.....	0.0	0.0	-0.6	-1.1	-1.2	-1.2	-1.3
DEFENSE - OIL.....							
DEFENSE - OTHER.....	0.0	0.0	-1.3	-2.2	-2.3	-2.5	-2.7
FEDERAL PAY:							
NONDEFENSE CIVILIANS.....	0.0	0.0	0.0	-0.2	-0.5	-0.6	-0.6
DEFENSE CIVILIANS.....	0.0	0.0	0.0	-0.2	-0.3	-0.4	-0.4
DEFENSE MILITARY.....	0.0	0.0	0.0	-0.3	-0.6	-0.7	-0.7
INTEREST RATES:							
RATES - GSL.....							
RATES - NET INTEREST.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
DEBT SERVICE.....	0.0	0.0	0.2	0.5	0.6	0.6	0.6
TOTAL OUTLAY CHANGES....	0.0	0.0	-3.7	-7.0	-8.6	-9.3	-9.6
ALTERNATE CASE OUTLAYS.....	851.8	946.1	988.8	1045.8	1109.3	1160.0	1215.2
SURPLUS/DEFICIT(-):							
BASE CASE.....	-185.3	-212.1	-212.4	-201.2	-179.7	-153.0	-130.1
CHANGES.....	0.0	0.0	-3.9	-2.4	-1.2	-1.5	-2.0
ALTERNATE CASE.....	-185.3	-212.1	-216.5	-203.6	-180.9	-154.5	-132.1

Pure Δ due to economies

EP PATH (OMB FORECAST)

** CURRENT SERVICES BASIS **

ESTIMATED BUDGET EFFECTS

(114) FIRST ALTERNATIVE: EP PATH
 COMPARED TO (113) MSR W/ +45 DAY 85:3 & LOWER 1986 INFLAT
 (FISCAL YEARS: BILLIONS OF DOLLARS)

COMPONENTS OF CHANGE	1984	1985	1986	1987	1988	1989	1990
BASE CASE RECEIPTS.....	655.5	734.0	772.3	842.2	928.9	1005.6	1083.1
INCOME TAXES:							
INDIVIDUAL - INCOMES.....	0.0	0.0	-1.3	-1.0	2.0	9.4	21.3
INDIVIDUAL - INDEXATION..	0.0	0.0	0.0	0.0	-0.5	-2.4	-6.2
CORPORATE.....	0.0	0.0	-0.2	-0.2	0.3	1.5	3.6
PAYROLL TAXES:							
SOC SECURITY & OTHER.....	0.0	0.0	-0.7	-0.5	1.0	4.7	10.8
UNEMPLOYMENT.....	0.0	0.0	-0.0	-0.0	-0.0	0.0	0.0
WINDFALL PROFIT TAXES.....	0.0	0.0	0.0	0.0	0.1	0.2	0.4
OTHER EXCISE TAXES.....	0.0	0.0	-0.0	-0.0	0.0	0.1	0.2
FRB DEPOSITS OF EARNINGS...	0.0	0.0	0.0	0.4	1.3	2.4	3.1
OTHER RECEIPTS.....	0.0	0.0	-0.0	-0.0	0.0	0.1	0.1
TOTAL RECEIPT CHANGES....	0.0	0.0	-2.2	-1.2	4.2	16.0	33.4
ALTERNATE CASE RECEIPTS....	666.5	734.0	770.1	841.0	933.1	1021.6	1116.5
BASE CASE OUTLAYS.....	851.8	946.1	988.8	1045.8	1109.8	1160.0	1215.2
UNEMPLOYMENT SENSITIVE:							
UI PROGRAM.....	0.0	0.0	0.3	0.5	1.2	1.9	2.6
OTHER.....	0.0	0.0	0.1	0.3	0.8	1.4	2.0
AUTOMATIC COLAS:							
SOCIAL SECURITY.....	0.0	0.0	0.0	0.0	1.0	3.6	8.2
OTHER INDEXED PROGRAMS...	0.0	0.0	0.0	0.0	0.4	1.4	3.1
HEALTH ENTITL./AFDC INFLAT.	0.0	0.0	0.0	0.2	0.9	2.2	4.0
DISCRETIONARY INFLATION:							
SPRO - OIL (OFF-BUDGET)..							
NONDEFENSE - OIL.....							
NONDEFENSE - OTHER.....	0.0	0.0	0.0	0.2	1.1	2.9	5.5
DEFENSE - OIL.....							
DEFENSE - OTHER.....	0.0	0.0	0.0	0.7	3.1	7.6	13.7
FEDERAL PAY:							
NONDEFENSE CIVILIANS.....	0.0	0.0	0.0	0.0	0.0	0.3	0.3
DEFENSE CIVILIANS.....	0.0	0.0	0.0	0.0	0.0	0.2	0.6
DEFENSE MILITARY.....	0.0	0.0	0.0	0.0	0.1	0.3	1.0
INTEREST RATES:							
RATES - GSL.....							
RATES - NET INTEREST.....	0.0	0.0	0.1	4.8	13.4	24.0	30.7
DEBT SERVICE.....	0.0	0.0	0.2	0.8	2.2	4.6	7.6
TOTAL OUTLAY CHANGES....	0.0	0.0	0.6	7.5	24.2	50.4	79.7
ALTERNATE CASE OUTLAYS....	851.8	946.1	989.4	1053.3	1134.0	1210.4	1294.9
SURPLUS/DEFICIT(-):							
BASE CASE.....	-185.3	-212.1	-216.5	-203.6	-180.9	-154.4	-132.1
CHANGES.....	0.0	0.0	-2.9	-8.7	-20.0	-34.4	-46.3
ALTERNATE CASE.....	-185.3	-212.1	-219.4	-212.3	-200.9	-188.8	-178.4

ESTIMATED BUDGET EFFECTS
 (115) SECOND ALTERNATIVE: EP REAL, MSR INFL.
 COMPARED TO (113) MSR W/ +45 DAY 85:3 & LOWER 1986 INFLA
 (FISCAL YEARS: BILLIONS OF DOLLARS)

COMPONENTS OF CHANGE	1984	1985	1986	1987	1988	1989	1990
BASE CASE RECEIPTS.....	665.5	734.0	772.3	842.2	928.9	1005.5	1083.1
INCOME TAXES:							
INDIVIDUAL - INCOMES.....	0.0	0.0	-1.3	-2.7	-6.7	-12.3	-18.0
INDIVIDUAL - INDEXATION..	0.0	0.0	0.0	0.0	0.0	0.0	0.0
CORPORATE.....	0.0	0.0	-0.2	-0.5	-1.2	-2.3	-3.4
PAYROLL TAXES:							
SOC SECURITY & OTHER.....	0.0	0.0	-0.7	-1.4	-3.5	-6.2	-9.3
UNEMPLOYMENT.....	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0
WINDFALL PROFIT TAXES.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER EXCISE TAXES.....	0.0	0.0	-0.0	-0.0	-0.1	-0.1	-0.2
FRB DEPOSITS OF EARNINGS...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER RECEIPTS.....	0.0	0.0	-0.0	-0.0	-0.0	-0.1	-0.1
TOTAL RECEIPT CHANGES....	0.0	0.0	-2.3	-4.7	-11.5	-21.0	-31.0
ALTERNATE CASE RECEIPTS.....	665.5	734.0	770.0	837.5	917.4	984.6	1052.1
BASE CASE OUTLAYS.....	851.8	946.1	988.8	1045.8	1109.8	1160.0	1215.2
UNEMPLOYMENT SENSITIVE:							
UI PROGRAM.....	0.0	0.0	0.3	0.5	1.2	1.9	2.6
OTHER.....	0.0	0.0	0.1	0.3	0.8	1.4	2.0
AUTOMATIC COLAS:							
SOCIAL SECURITY.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER INDEXED PROGRAMS...	0.0	0.0	0.0	0.0	0.0	0.0	0.0
HEALTH ENTITL./AFDC INFLAT.	0.0	0.0	0.0	0.0	0.0	-0.0	-0.0
DISCRETIONARY INFLATION:							
SPRO - OIL (OFF-BUDGET)...							
NONDEFENSE - OIL.....							
NONDEFENSE - OTHER.....	0.0	0.0	0.0	0.0	0.0	-0.0	-0.0
DEFENSE - OIL.....							
DEFENSE - OTHER.....	0.0	0.0	0.0	0.0	0.0	-0.0	-0.0
FEDERAL PAY:							
NONDEFENSE CIVILIANS.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
DEFENSE CIVILIANS.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
DEFENSE MILITARY.....	0.0	0.0	0.0	0.0	0.0	0.0	0.1
INTEREST RATES:							
RATES - GSL.....							
RATES - NET INTEREST.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
DEBT SERVICE.....	0.0	0.0	0.2	0.6	1.5	2.8	4.6
TOTAL OUTLAY CHANGES.....	0.0	0.0	0.5	1.4	3.5	6.1	9.3
ALTERNATE CASE OUTLAYS.....	851.8	946.1	989.3	1047.2	1113.3	1166.1	1224.5
SURPLUS/DEFICIT(-):							
BASE CASE.....	-185.3	-212.1	-216.5	-203.6	-180.9	-154.4	-132.1
CHANGES.....	0.0	0.0	-2.8	-6.1	-15.0	-27.1	-40.3
ALTERNATE CASE.....	-185.3	-212.1	-219.3	-209.7	-195.9	-181.5	-172.4

Baseline real 0 inflation in 88:3 0.4% 0.2% 0 →
88:1

** CURRENT SERVICES BASIS **

ESTIMATED BUDGET EFFECTS
(116) ALTERNATIVE 3: PRICE STABILITY 88
COMPARED TO (113) MSR W/ +45 DAY 85:3 & LOWER 1986 INFLAT.
(FISCAL YEARS: BILLIONS OF DOLLARS)

COMPONENTS OF CHANGE	1984	1985	1986	1987	1988	1989	1990
BASE CASE RECEIPTS.....	666.5	734.0	772.3	842.2	928.9	1005.6	1083.1
INCOME TAXES:							
INDIVIDUAL - INCOMES.....	0.0	0.0	-2.1	-14.7	-36.0	-62.5	-89.4
INDIVIDUAL - INDEXATION..	0.0	0.0	0.0	0.5	3.7	9.2	15.5
CORPORATE.....	0.0	0.0	-0.4	-2.3	-6.4	-11.8	-17.3
PAYROLL TAXES:							
SOC SECURITY & OTHER.....	0.0	0.0	-1.1	-7.5	-18.8	-32.4	-47.2
UNEMPLOYMENT.....	0.0	0.0	0.0	-0.0	-0.0	-0.1	-0.1
WINDFALL PROFIT TAXES.....	0.0	0.0	0.0	-0.2	-0.5	-0.0	0.0
OTHER EXCISE TAXES.....	0.0	0.0	-0.0	-0.2	-0.5	-0.8	-1.1
FRB DEPOSITS OF EARNINGS...	0.0	0.0	-0.2	-1.7	-3.5	-4.9	-6.0
OTHER RECEIPTS.....	0.0	0.0	-0.0	-0.1	-0.2	-0.4	-0.6
TOTAL RECEIPT CHANGES....	0.0	0.0	-3.9	-26.3	-62.2	-103.7	-146.3
ALTERNATE CASE RECEIPTS.....	666.5	734.0	768.4	815.9	866.7	901.9	936.3
BASE CASE OUTLAYS.....	851.8	946.1	988.8	1045.8	1109.8	1160.0	1215.2
UNEMPLOYMENT SENSITIVE:							
UI PROGRAM.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
OTHER.....	0.0	0.0	0.0	0.0	0.0	0.0	0.0
AUTOMATIC COLAS:							
SOCIAL SECURITY.....	0.0	0.0	0.0	-5.5	-7.6	-14.4	-23.3
OTHER INDEXED PROGRAMS...	0.0	0.0	-0.0	-1.1	-2.7	-5.6	-8.8
HEALTH ENTITL./AFDC INFLAT.	0.0	0.0	-0.2	-1.5	-3.7	-6.6	-9.6
DISCRETIONARY INFLATION:							
SPRO - OIL (OFF-BUDGET)..							
NONDEFENSE - OIL.....							
NONDEFENSE - OTHER.....	0.0	0.0	-0.3	-1.9	-5.1	-9.3	-13.6
DEFENSE - OIL.....							
DEFENSE - OTHER.....	0.0	0.0	-0.8	-5.5	-12.9	-22.1	-31.6
FEDERAL PAY:							
NONDEFENSE CIVILIANS.....	0.0	0.0	0.0	-0.0	-0.4	-1.3	-2.5
DEFENSE CIVILIANS.....	0.0	0.0	0.0	-0.0	-0.3	-0.9	-1.3
DEFENSE MILITARY.....	0.0	0.0	0.0	-0.0	-0.5	-1.6	-3.1
INTEREST RATES:							
RATES - GSL.....							
RATES - NET INTEREST.....	0.0	0.0	-3.0	-16.5	-31.2	-37.7	-45.3
DEBT SERVICE.....	0.0	0.0	-0.0	-0.3	-0.5	-0.4	-0.1
TOTAL OUTLAY CHANGES.....	0.0	0.0	-4.3	-32.4	-64.9	-99.9	-139.3
ALTERNATE CASE OUTLAYS.....	851.8	946.1	984.5	1013.4	1044.9	1060.1	1075.4
SURPLUS/DEFICIT(-):							
BASE CASE.....	-185.3	-212.1	-216.5	-203.6	-180.9	-154.4	-132.1
CHANGES.....	0.0	0.0	0.4	6.2	2.7	-3.8	-6.5
ALTERNATE CASE.....	-185.3	-212.1	-216.1	-197.4	-178.2	-158.2	-138.6

Baseline $\frac{1}{2}\%$ real + $\frac{1}{2}\%$ inflation

** CURRENT SERVICES BASIS **

ESTIMATED BUDGET EFFECTS

(117) ALTERNATIVE 4: LESS REAL, MORE INFL.

COMPARED TO (113) MSR W/ +45 DAY 85:3 & LOWER 1986 INFLATI

(FISCAL YEARS: BILLIONS OF DOLLARS)

-20 bill
in GNP\$
by 1990

COMPONENTS OF CHANGE	1984	1985	1986	1987	1988	1989	1990
BASE CASE RECEIPTS.....	665.5	734.0	772.3	842.2	928.9	1005.6	1083.1
INCOME TAXES:							
INDIVIDUAL - INCOMES.....	0.0	0.0	-1.8	-2.0	-2.2	-2.5	-2.3
INDIVIDUAL - INDEXATION..	0.0	0.0	0.0	-0.0	-0.4	-1.5	-3.0
CORPORATE.....	0.0	0.0	-0.2	-0.4	-0.5	-0.5	-0.5
PAYROLL TAXES:							
SOC SECURITY & OTHER.....	0.0	0.0	-1.0	-1.0	-1.1	-1.3	-1.4
UNEMPLOYMENT.....	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0
WINDFALL PROFIT TAXES.....	0.0	0.0	0.0	0.0	0.1	0.1	0.1
OTHER EXCISE TAXES.....	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0
FRB DEPOSITS OF EARNINGS...	0.0	0.0	0.0	0.2	0.8	1.3	1.5
OTHER RECEIPTS.....	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0
TOTAL RECEIPT CHANGES....	0.0	0.0	-3.1	-3.2	-3.4	-4.3	-6.1
ALTERNATE CASE RECEIPTS....	665.5	734.0	769.2	839.0	925.5	1001.3	1077.0
BASE CASE OUTLAYS.....	851.8	946.1	988.8	1045.8	1109.8	1160.0	1215.2
UNEMPLOYMENT SENSITIVE:							
UI PROGRAM.....	0.0	0.0	0.3	0.5	1.2	1.9	2.6
OTHER.....	0.0	0.0	0.1	0.3	0.8	1.4	2.0
AUTOMATIC COLAS:							
SOCIAL SECURITY.....	0.0	0.0	0.0	0.0	0.8	2.2	3.9
OTHER INDEXED PROGRAMS...	0.0	0.0	0.0	0.0	0.3	0.9	1.5
HEALTH ENTITL./AFDC INFLAT.	0.0	0.0	0.0	0.1	0.5	1.1	1.7
DISCRETIONARY INFLATION:							
SPRO - OIL (OFF-BUDGET) ..							
NONDEFENSE - OIL.....							
NONDEFENSE - OTHER.....	0.0	0.0	0.0	0.2	0.7	1.5	2.4
DEFENSE - OIL.....							
DEFENSE - OTHER.....	0.0	0.0	0.0	0.5	1.9	3.8	5.7
FEDERAL PAY:							
NONDEFENSE CIVILIANS.....	0.0	0.0	0.0	0.0	0.0	0.2	0.4
DEFENSE CIVILIANS.....	0.0	0.0	0.0	0.0	0.0	0.1	0.3
DEFENSE MILITARY.....	0.0	0.0	0.0	0.0	0.1	0.2	0.5
INTEREST RATES:							
RATES - GSL.....							
RATES - NET INTEREST.....	0.0	0.0	0.1	3.1	9.3	16.8	19.4
DEBT SERVICE.....	0.0	0.0	0.2	0.9	2.4	4.9	7.8
TOTAL OUTLAY CHANGES....	0.0	0.0	0.7	5.6	18.0	34.9	48.2
ALTERNATE CASE OUTLAYS....	851.8	946.1	989.5	1051.4	1127.8	1194.9	1263.4
SURPLUS/DEFICIT(-):							
BASE CASE.....	-185.3	-212.1	-216.5	-203.6	-180.9	-154.4	-132.1
CHANGES.....	0.0	0.0	-3.8	-8.9	-21.5	-39.2	-54.4
ALTERNATE CASE.....	-185.3	-212.1	-220.3	-212.5	-202.4	-193.6	-186.5

Comparison of Budget Estimates:
Mid-Session Current Services, Updated Mid-Session Baseline,
and Four Alternative Forecasts

(fiscal years: in billions of dollars)

	1985	1986	1987	1988	1989	1990
Receipts:	-----	-----	-----	-----	-----	-----
Mid-Session current services.....	736.0	780.1	851.6	938.7	1016.3	1094.7
Baseline--updated Mid-Session.....	734.0	772.3	842.2	928.9	1005.6	1083.1
Alt. 1: EP forecast.....	734.0	770.1	841.0	933.1	1021.6	1116.5
Alt. 2: EP real, updated MSR inflation.	734.0	770.0	837.5	917.4	984.6	1052.1
Alt. 3: price stability by 1988.....	734.0	768.4	815.9	866.7	901.9	936.8
Alt. 4: less real, more inflation.....	734.0	769.2	839.0	925.5	1001.3	1077.0
Outlays:						
Mid-Session current services.....	947.1	1022.7	1104.7	1194.6	1260.1	1332.6
Baseline--updated Mid-Session.....	946.1	988.8	1045.8	1109.8	1160.0	1215.2
Alt. 1: EP forecast.....	946.1	989.4	1053.3	1134.0	1210.4	1294.9
Alt. 2: EP real, updated MSR inflation.	946.1	989.3	1047.2	1113.3	1156.1	1224.5
Alt. 3: price stability by 1988.....	946.1	984.5	1013.4	1044.9	1060.1	1075.4
Alt. 4: less real, more inflation.....	946.1	989.5	1051.4	1127.8	1194.9	1263.4
Deficits:						
Mid-Session current services.....	-211.1	-242.6	-253.1	-255.9	-243.8	-237.9
Baseline--updated Mid-Session.....	-212.1	-216.5	-203.6	-180.9	-154.4	-132.1
Alt. 1: EP forecast.....	-212.1	-219.4	-212.3	-200.9	-188.8	-178.4
Alt. 2: EP real, updated MSR inflation.	-212.1	-219.3	-209.7	-195.9	-181.5	-172.4
Alt. 3: <u>price stability by 1988.....</u>	-212.1	-216.1	-197.4	-178.2	-158.2	-138.6
Alt. 4: less real, more inflation.....	-212.1	-220.3	-212.5	-202.4	-193.6	-186.5

MSR
+T286

Adjusted current services baseline with CBC Defense and The pay freeze

FORECAST COMPARISON
(CALENDAR YEARS)

	1984	1985	1986	1987	1988	1989	1990
NOMINAL GNP: LEVEL (\$ BILLION):		3894.4	4195.1	4535.6			5647
MID-SESSION REVIEW.....	3563	3926	4237	4589	4959	5338	5714
UPDATED BASELINE.....	3553	3895	4195	4542	4909	5283	5655
ALTERNATIVE 1.....	3553	3892	4185	4538	4934	5368	5833
ALTERNATIVE 2.....	3563	3892	4185	4516	4851	5184	5517
ALTERNATIVE 3.....	3563	3895	4163	4398	4595	4774	4947
ALTERNATIVE 4.....	3563	3891	4181	4527	4892	5265	5635
% CHANGE, 4TH/4TH:			7.9				
MID-SESSION REVIEW.....	9.5	7.1	8.4	8.3	7.9	7.4	6.9
UPDATED BASELINE.....	9.5	6.4	8.1	8.3	7.9	7.4	6.9
ALTERNATIVE 1.....	9.5	6.1	8.1	9.5	8.3	8.7	8.7
ALTERNATIVE 2.....	9.5	6.1	8.0	7.7	7.2	6.7	6.3
ALTERNATIVE 3.....	9.5	6.4	6.4	5.2	4.2	3.7	3.5
ALTERNATIVE 4.....	9.5	6.0	8.1	8.3	7.9	7.4	6.9
REAL GNP, % CHANGE, 4TH/4TH:							
MID-SESSION REVIEW.....	5.7	3.0	4.0	4.0	4.0	3.8	3.6
UPDATED BASELINE.....	5.7	3.0	4.0	4.0	4.0	3.8	3.6
ALTERNATIVE 1.....	5.7	2.7	4.0	3.5	3.3	3.0	3.0
ALTERNATIVE 2.....	5.7	2.7	4.0	3.5	3.3	3.0	3.0
ALTERNATIVE 3.....	5.7	3.0	4.0	4.0	4.0	3.7	3.6
ALTERNATIVE 4.....	5.7	2.6	3.9	3.5	3.3	3.0	3.0
GNP DEFLATOR, % CHANGE, 4TH/4TH:							
MID-SESSION REVIEW.....	3.6	4.0	4.3	4.1	3.3	3.5	3.2
UPDATED BASELINE.....	3.6	3.3	3.9	4.1	3.3	3.5	3.2
ALTERNATIVE 1.....	3.6	3.3	4.0	4.9	5.4	5.5	5.5
ALTERNATIVE 2.....	3.6	3.3	3.9	4.1	3.3	3.5	3.2
ALTERNATIVE 3.....	3.6	3.3	2.3	1.1	0.1	0.0	0.0
ALTERNATIVE 4.....	3.6	3.3	4.0	4.6	4.5	4.2	3.8
UNEMPLOYMENT RATE:							
MID-SESSION REVIEW.....	7.4	7.1	6.8	6.6	6.3	6.1	5.8
UPDATED BASELINE.....	7.4	7.1	6.8	6.6	6.3	6.1	5.8
ALTERNATIVE 1.....	7.4	7.1	7.0	6.9	6.9	6.9	7.0
ALTERNATIVE 2.....	7.4	7.1	7.0	6.9	6.9	6.9	7.0
ALTERNATIVE 3.....	7.4	7.1	6.8	6.6	6.3	6.1	5.8
ALTERNATIVE 4.....	7.4	7.1	7.0	6.9	6.9	6.9	7.0
INTEREST RATES:							
91-DAY TREASURY BILLS:							
MID-SESSION REVIEW.....	9.6	7.6	7.5	7.0	5.9	5.1	5.0
UPDATED BASELINE.....	9.6	7.6	7.5	7.0	5.9	5.1	5.0
ALTERNATIVE 1.....	9.6	7.6	7.7	7.9	7.5	7.0	6.7
ALTERNATIVE 2.....	9.6	7.6	7.5	7.0	5.9	5.1	5.0
ALTERNATIVE 3.....	9.6	7.6	5.9	4.0	2.3	1.6	1.5
ALTERNATIVE 4.....	9.6	7.6	7.5	7.5	6.6	5.8	5.5
10-YEAR TREASURY NOTES:							
MID-SESSION REVIEW.....	12.4	10.8	9.9	9.0	7.3	5.7	5.5
UPDATED BASELINE.....	12.4	10.7	9.9	9.0	7.3	5.7	5.5
ALTERNATIVE 1.....	12.4	10.7	10.1	9.9	8.3	7.6	7.2
ALTERNATIVE 2.....	12.4	10.7	9.9	9.0	7.3	5.7	5.5
ALTERNATIVE 3.....	12.4	10.7	9.0	7.4	5.3	3.9	2.4
ALTERNATIVE 4.....	12.4	10.7	10.2	9.8	8.8	7.3	6.2
DOMESTIC OIL PRICES (\$/BBL):							
MID-SESSION REVIEW.....	28.53	25.77	24.86	25.87	26.92	27.89	28.82
UPDATED BASELINE.....	28.53	25.77	24.86	25.87	26.92	27.89	28.82
ALTERNATIVE 1.....	28.53	25.77	24.86	25.99	27.37	28.87	30.45
ALTERNATIVE 2.....	28.53	25.77	24.86	25.87	26.92	27.89	28.82
ALTERNATIVE 3.....	28.53	25.77	24.82	25.29	25.44	25.44	25.44
ALTERNATIVE 4.....	28.53	25.77	24.86	25.96	27.17	28.35	29.45

8821 3.1

3.4

3.8

4.2

4.2

Mr Sprinkel



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

July 3, 1985

MEMORANDUM FOR T-1

From: T-2 (Eickhoff, Johnson, and Anderson) *ME JJA LA*

Subject: Mid-Session Review Forecast Options

T-2 met June 5 to discuss the major considerations underlying the 1985-1990 economic forecast. While we are in agreement on the general outlines of the forecast, some differences have emerged.

In all cases, our disagreements are narrow, both in absolute terms and in comparison with the range of uncertainty surrounding the forecast. The forecast recommendations reflect a consensus on policy assumptions of moderate restraint in money growth and full implementation of Federal spending restraint along the lines of the Senate proposal. Private forecasters assign a probability of less than one to these policy assumptions and instead assume higher money and spending growth. Consequently, the consensus expects higher inflation and lower real growth in the period ahead.

The 1985 Outlook

For real GNP, fourth quarter over fourth quarter, T-2 recommends a forecast of 3 to 3-1/2 percent real growth in 1985. This forecast range assumes a strong second half growth of 4-1/2 to 5-1/2 percent at an annual rate. The forecast of a rebound in real growth is based on the acceleration in money growth that has occurred over the last 7 months and favorable stock-flow relationships that are developing in the second quarter.

Eickhoff is marginally less optimistic than Johnson and Anderson because of the continued "drag" from trade deficits and slow investment growth. The latest (June 10) Blue Chip consensus forecast is 2.7 percent real growth (IV/IV)

Real GNP Growth (1985IV/1984IV)

April Update

3.9%

T-2

3% to 3.5%

For the GNP deflator, fourth quarter over fourth quarter, T-2 recommends a forecast of 4.3 percent and assumes the inflation rate will average 4.3 percent in the second half. This would leave second half inflation equal to the assumed inflation in 1986. Clearly, the first quarter estimate was high due to several temporary factors -- mix shifts in composition and the Federal pay raise -- that had effects in the first quarter only. The second quarter's 3.2 percent was low for similar reasons.

GNP Deflator Growth (1985IV/1984IV)

<u>April Update</u>	<u>T-2</u>
4.2%	4.3%

The unemployment rate projection for 1985, averaging 7.0 percent may be marginally low since the rate has been 7.2 percent for the past four months. However, we would stay with the April Update for now.

Unemployment Rate (average for 1985)

<u>April Update</u>	<u>T-2</u>
7.0%	7.0%

The interest rate projections for 1985 in the April update, averaging 8.1 percent on 91-day bills and 11.0 percent on long-term Treasury bonds in the April Update, appear high. Currently, the bill rate is 7.0 percent and the long-bond rate is 10.4 percent. We expect the bill rate to rise somewhat over the second half as real growth accelerates and we expect the long-bond rate to remain stable at current levels for the remainder of the year. Consequently, we now expect the bill rate to average 7.5 percent and the long bond rate to average 10.8 percent in 1985.

The assumed 50 basis point increase in the bill rate in the second half is consistent with the assumed rebound in real growth and current yield in the futures market. The assumption of stable long rates is at odds with the futures market (where a 30 basis-point rise is expected) but is consistent with our policy assumptions.

Interest Rates (average for 1985)

<u>April Update</u>		<u>T-2</u>	
<u>91-Day Bill</u>	<u>Long Bond</u>	<u>91-Day Bill</u>	<u>Long Bond</u>
8.1%	11.0%	7.5%	10.8%

The 1986-90 Outlook

The basic policy assumptions -- steady and moderate reductions in money growth and a fiscal policy along the lines of the Senate Resolution -- condition our longer-term economic assumptions.

Over this period, the current real growth and inflation forecasts depart substantially from many private forecasts. On the one hand, the Blue Chip consensus shows real growth at a 3.3 percent yearly average over the 1986-1990 period and inflation at 4.4 percent per year. On the other hand, the Blue Chip assumption of 7.8 percent average nominal GNP growth is only 0.1 percent below our current forecast.

For real GNP, T-2 recommends that the current set of forecast growth rates remain unchanged. Reducing the outyear real growth forecast coincident with the Presidential tax initiative could be misconstrued.

Real GNP Growth (IV/IV)

	<u>April Update</u>	<u>T-2</u>
1986	4.0%	4.0%
1987	4.0	4.0
1988	4.0	4.0
1989	3.8	3.8
1990	3.6	3.6

The inflation projection has served us well over the past two years. Over this period, the successive near-term Administration projections have been considered optimistic by many private forecasters. In fact, the projections have generally overstated inflation leading to successive downward revisions from one Budget update to the next.

Monetary restraint over 1980-1982 reversed rising inflation. Since 1982, normal cyclical forces, the strong dollar, corrections in oil prices, and major adjustments in U.S. labor markets have played important roles in this process. To date, we have not seen a sustained gradual slowdown in money growth. Over the past 4 years, trend money growth has increased compared with the previous 4 years. In addition, the variability of money growth around trend has also increased. These results are due, in part, to shifts in money demand associated with deregulation and reform of the U.S. banking and monetary system. However, an assumption of further large increases in money demand is difficult to justify.

Consequently, we are near a decisive point in monetary policy. A major surge in money growth over the last 7 months was required

to offset the previous slowdown. (The alternative "growth band" for 1985 was provided for precisely this reason.) A gradual transition to moderately slower money growth is now required to prevent an acceleration in inflation in 1986 which could lead to another recession by 1987 or 1988.

T-2 has assumed such a transition will occur and that money growth will gradually decelerate. Consequently, we recommend that the assumed inflation projections remain basically unchanged. An increase in the inflation assumption in 1986 would make up for some of the nominal GNP shortfall in 1985. However, an upward revision might send the wrong signal to the Fed and the public.

For the period 1987-90, T-2 presently recommends no change in the inflation projection.

GNP Deflator Growth (IV/IV)

	<u>April Update</u>	<u>T-2</u>
1986	4.3%	4.3%
1987	4.1	4.1
1988	3.8	3.8
1989	3.5	3.5
1990	3.2	3.2

The unemployment rate projection is on track.

Unemployment Rate (annual average)

	<u>April Update</u>	<u>T-2</u>
1986	6.9%	6.9%
1987	6.6	6.6
1988	6.3	6.3
1989	6.1	6.1
1990	5.8	5.8

The interest rate projection is based on an assumed gradual decline in real rates. The April Update real bill rate was assumed to fall to 1.8 percent and the real long bond rate to 2.3 percent by 1990. Based on recent experience, Eickhoff thinks these terminal rates assume too rapid an elimination of inflation rate premiums. She recommends an 80 basis point increase in short rates and 130 basis points in long rates. Johnson and Anderson recommend no change from the current terminal forecast.

If the T-2 recommendations for 1985 are accepted, a smooth assumed decline would require reductions in forecast values for 1986 and 1987.

Interest Rates (annual average)

	April Update		Eickhoff		Johnson/ Anderson	
	91-Day Bills	Long Bonds	91-Day Bills	Long Bonds	91-Day Bills	Long Bonds
1985	8.1%	11.0%	7.6%	10.8%	7.6%	10.8%
1986	7.9	10.3	7.5	10.0	7.5	10.0
1987	7.2	9.3	7.0	9.3	7.0	9.0
1988	5.9	7.3	6.6	8.3	5.9	7.3
1989	5.1	5.7	6.2	7.5	5.1	5.7
1990	5.0	5.5	5.8	6.8	5.0	5.5

Oil price assumptions should take into account the weakening oil market and the disarray in OPEC. We assume that the import oil refinery acquisition cost (IRAC) declines to \$25 a barrel by the final quarter of this year, remains essentially at that level through 1986, and advances with the rate of the GNP deflator thereafter.

Oil Price Assumptions

	<u>April Update</u>	<u>T-2</u>
1985	27.20	26.50
1986	27.00	25.07
1987	27.07	26.00
1988	27.66	26.93
1989	28.68	27.90
1990	29.88	28.82

The natural gas price projections in both the FY 1986 Budget and April Update assumed implementation of the Administration's decontrol proposal on July 1, 1985. Total decontrol legislation, as envisioned under the Administration's proposal, in all likelihood and under the best circumstances, could not be enacted until January 1, 1986. We recommend January 1, 1986 as the assumed decontrol date for the Mid-Session Review natural gas price assumptions.

Other Issues

Fiscal Policy: T-2 requires guidance on the budget assumptions. Will the Mid-Session Review adopt the Senate resolution, a compromise between the House and Senate, or the original Budget proposal?

Tax Policy: Is the President's tax proposal to be incorporated in this update?

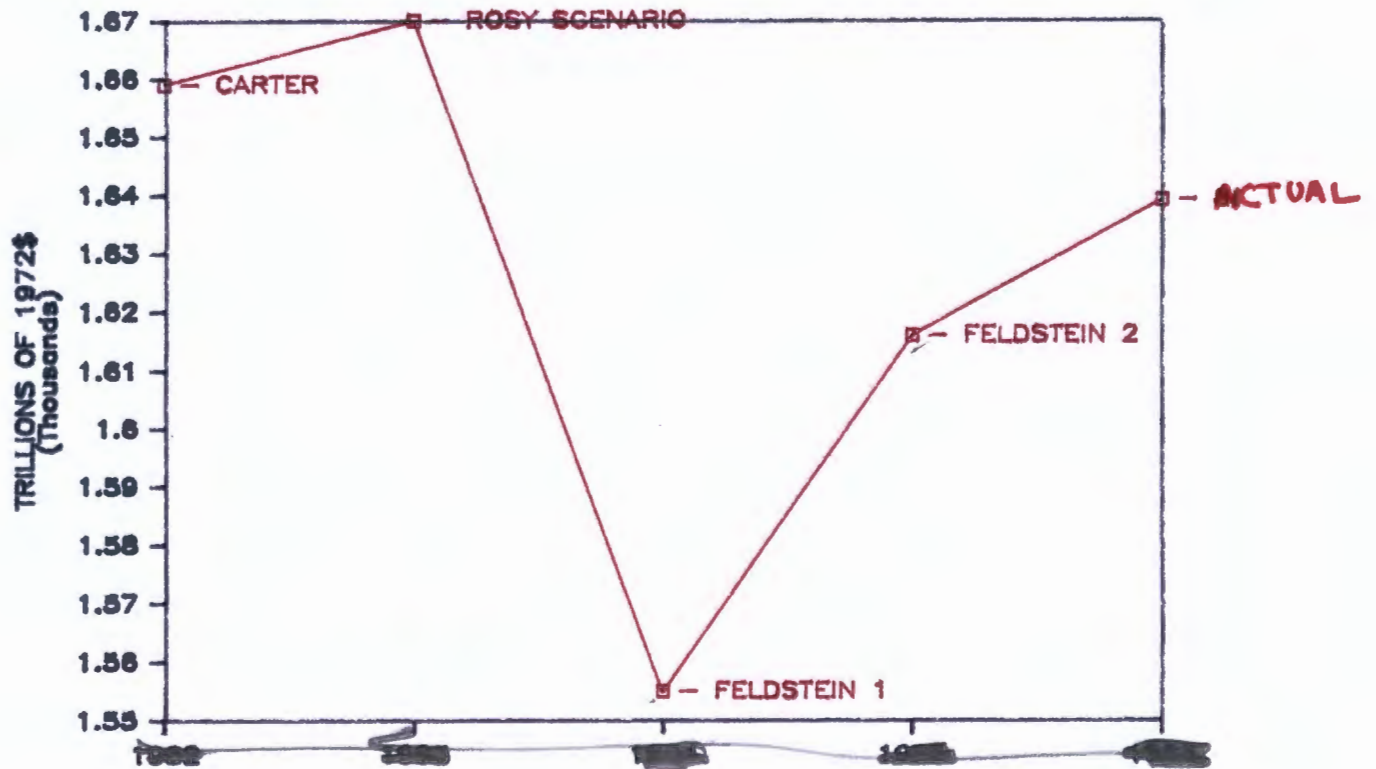
Dollar Value: The current forecast assumption calls for no change in the dollar's value. Eickhoff thinks this assumption is inconsistent with the forecast composition of real GNP, raising concern about our ability to achieve the assumed real growth. The sharp improvement in net exports 1987-90 in the assumptions is unlikely without an assist from a declining dollar. Johnson and Anderson disagree. They think the assumed improvement (to +\$30 billion in 1990, compared with +\$50 billion in 1980 and -\$25 billion in 1985) can be achieved if real growth accelerates abroad and domestic export industries reduce unit labor costs. Other factors, like a reduction in agricultural support prices, would also improve the trade balance. Eickhoff sees these assumptions as highly unlikely to occur to the degree required. It is important to note that the assumed dollar value will have a substantial impact on Commodity Credit Corporation outlay estimates (a decline in the dollar would reduce CCC outlays by diverting agricultural stocks to overseas sales).

Current Mid-Session Review Schedule

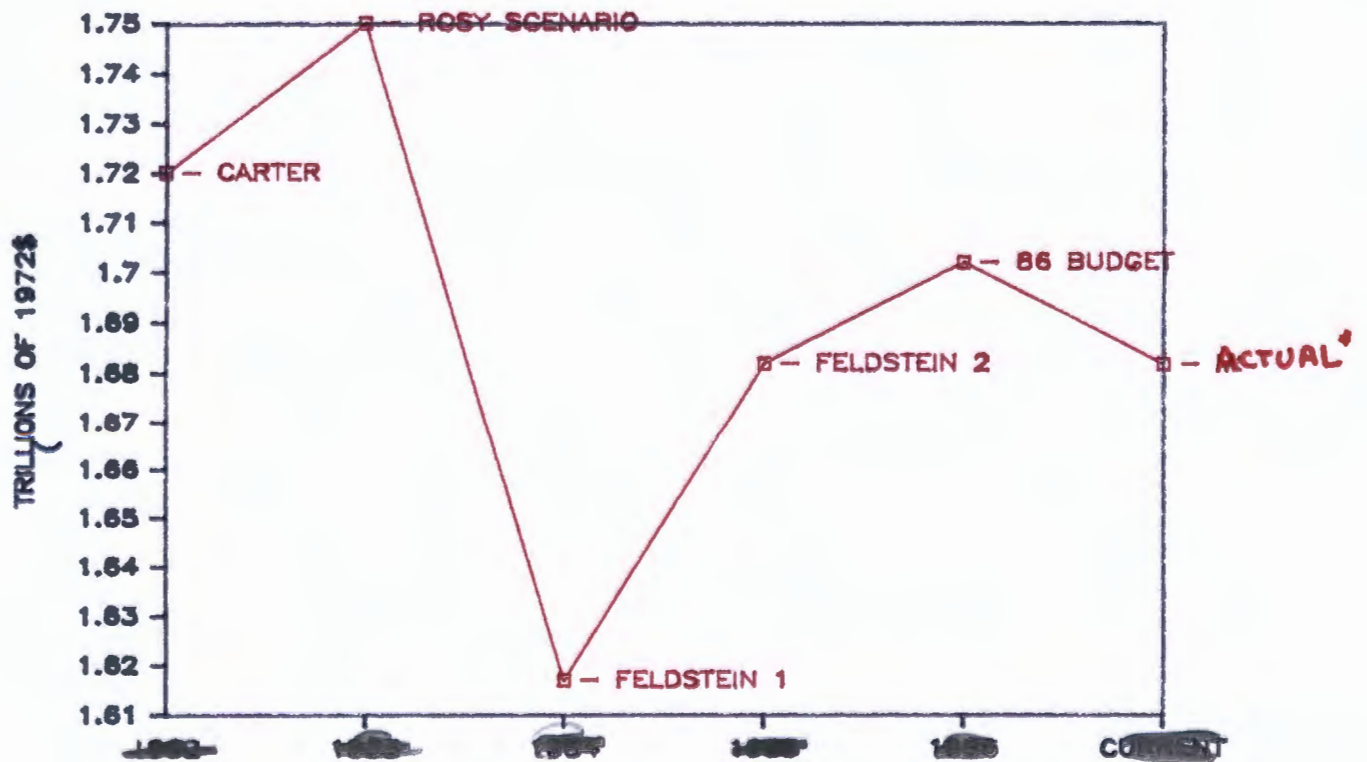
July 10-16	Run of blackbox in preparation for update.
July 17-18	Incorporate preliminary second quarter GNP in blackbox.
July 19-21	Finalize economic assumptions and distribute to Agencies.
August 15	Distribute Mid-Session Review to Congress.

TRACK RECORD

LEVEL REAL GNP FORECAST FOR 1984



LEVEL REAL GNP FORECAST FOR 1985



4 5% 1984 ESTIMATE