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## Economic Assumptions

(For mid-year Review)

- I. In view of the extraordinary first quarter 1981 increases in nominal income and real output, some revisions of the economic assumptions were necessary.
1. The levels of nominal income for 1981 were increased \$31.5 billion, output was increased \$21.3 billion.
  2. Nominal income in 1982 was increased by \$2.7 billion, but held virtually unchanged for 1983-86.
  3. Real output was increased in each subsequent year as follows:

1982,	\$10.1 billion
1983,	9.7 billion
1984,	10.4 billion
1985,	11.2 billion
1986,	11.7 billion
  4. Growth of real output was increased:
    - 1980 to 1982 from 5.3% to 6.0%
    - Q4/1980 to Q4/1982 from 7.0% to 7.8%
    - output growth rates for 1983-86 unchanged
    - output growth rate during 1982 (Q4/81-Q4/82) unchanged
  5. Inflation assumptions were lowered for 1981 and 1982; unchanged for 1983-86.
- II. Potential problems with the economic assumptions.
1. The February assumptions included a somewhat larger, and earlier, personal income tax rate reduction than is now likely.
  2. The initial effects of a more restrictive monetary policy and reduced growth of government spending might cause nominal income growth to decline faster than inflation for one or two quarters, resulting in reports of declining output.
  3. However, declining real oil prices, a strong dollar, and general optimism about the future may produce a faster decline of inflation.
  4. By definition, eventual elimination of inflation means nominal income and real output would grow at the same rates; our economic assumptions have nominal income growing faster for the next five years than in 1980!

5. The February assumptions included a 50% reduction in monetary growth from 1980 to 1986; however, money (M1B) growth in the first half of 1981 has been at a more rapid rate than for all of 1980.
  - a. Unless there is a sharp reduction of money growth in the second half of this year, growth for the full year will exceed 1980.
  - b. If a sharp reduction of money growth occurs this year, nominal income growth in 1982 will be lower than assumed.
  - c. The nominal income growth assumptions for 1983-86 are considerably faster than are consistent with a 50% reduction in money growth by 1986.