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Strictly Confidential (FR) Class II FOMC

Part 1

March 19 1997

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

Prepared for the Federal Open Market Committee
By the staff of the Board of Governors of the Federal Reserve System

Strictly Confidential (FR) Class II FOMC

March 19, 1997

SUMMARY AND OUTLOOK

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Domestic Developments

Summary

Contrary to our expectations--and those of most other analysts--the economic expansion has shown little, if any, sign of moderating in the wake of the surge in the closing months of 1996. Most notably, jobs continue to be created at a brisk pace, lifting personal income and consumer spirits; and retail sales reportedly have been booming. Fortunately, aggregate supply apparently has been expanding apace, with the labor force continuing to grow rapidly and factory capacity evidently still increasing smartly; moreover, an appreciating dollar has helped to enhance effective supply by making imports available more cheaply. As a consequence, inflation has remained in check, with scarcely any increase in the prices of manufactured goods.

Conceivably, this favorable pattern could persist for a while longer. But it is our assessment that, absent a substantial near-term tightening of monetary policy, we are likely to see mounting pressures on resources--particularly labor--and the emergence of a significant uptrend in price inflation. In our baseline economic scenario, real GDP rises at a bit more than a 3 percent annual rate in the first half of 1997 and then moderates to a 2-1/2 percent pace in the second half and about 2 percent in 1998. Such output growth pushes the unemployment rate below 5 percent, and the tightness of the labor market causes employers to bid up wages and benefits to attract workers. Core CPI inflation, which has been just 2-1/2 percent over the past twelve months, is projected to move up to 2-3/4 percent this year and 3-1/4 percent in 1998, the magnitude of the acceleration being muted slightly by planned BLS technical changes. Overall inflation should be damped relative to the core rate by favorable movements in food and, especially, energy prices: we see the total CPI rising only 3 percent next year.

The outlook for inflationary pressures would be more adverse were it not for certain key elements in our baseline forecast. First, on the demand side, it is our expectation that the deterioration in the U.S. terms of trade will be damping the growth of exports and encouraging rising import penetration for some time--even if, as we've anticipated, the run-up in the dollar has run its course. Second, financial market participants have shown some sensitivity to the potential for Federal Reserve tightening, especially in light of Chairman Greenspan's recent testimony. As they perceive inflationary risks to be mounting in coming months, intermediate- and long-term interest rates are likely to move to higher levels. That tendency is reinforced in 1998 by an assumed moderate rise in the federal funds rate. The stock market probably will find it difficult to make any further headway in such an environment, and, indeed, we have predicted a downturn in share prices next year. Thus, financial forces are expected to curb domestic demand growth to a degree over time. Finally, on the supply side, we have anticipated that inflationary pressures will be muted by continued above-trend growth in the labor force and ample expansion of factory capacity.

Summary of the Staff Forecast
(Percent change, Q4 to Q4, except as noted)

Measure	1996	1997	1998
Real GDP	3.2	2.8	2.1
Previous	3.1	2.3	2.1
Gross domestic purchases	3.4	3.5	2.4
Previous	3.3	2.9	2.2
Consumer price index	3.2	2.5	3.0
Previous	3.1	2.6	3.0
Excluding food and energy	2.6	2.8	3.2
Previous	2.6	2.8	3.2
Unemployment rate[1]	5.3	5.0	4.9
Previous	5.3	5.1	5.0

1. Percent, end of period.

As always, there is a considerable range of uncertainty attending our forecast. We have warned previously of the potential for a sustained boom in domestic demand, supported by a strong stock market and aggressive lending. Recent developments have done nothing to undermine that assessment. On the other hand, we cannot rule out the possibility that various influences will prove even more favorable for the prospects for low inflation than we have anticipated. The dollar could break out into still higher territory on the basis of optimism about U.S. growth prospects relative to the economic struggles in continental Europe, for example; there may be some room for the labor force to increase more rapidly than we have projected, although this would involve hiring less qualified workers; and it may be that the recent performance of prices and profits is signaling the emergence of a better productivity trend, perhaps based on the realization of greater efficiencies from the investments that have been made in new technologies. We would emphasize, however, that unless aggregate demand flags to a greater degree than we are anticipating or there are some positive supply shocks, the thrust of our baseline forecast is that pressures on domestic resources will manifest themselves in a rising inflation rate over the next few years.

Key Background Factors in the Forecast

Over the intermeeting period, financial markets have been whipsawed somewhat by data showing greater-than-expected growth and less-than-anticipated inflation. On net, though, 30-year Treasury bond yields have neared the 7 percent mark on perceptions that a tightening of monetary policy might occur sooner rather than later. Given the absence of immediate policy action in this forecast, we expect bond prices to rally a bit in the near term. But the yield curve is expected to steepen again later this year and in early 1998 as unemployment drops and inflation picks up--and the markets place greater odds on Fed tightening. As noted, we have in fact assumed that the federal funds rate will be raised moderately during 1998, essentially to match the rise in core inflation and thus to prevent what would otherwise be a decline in real short-term rates. Bond yields are projected to remain somewhat above the recent range next year, but with the yield curve flattening considerably as the System tightens.

Equity prices have again exceeded our expectations as fourth-quarter corporate reports were favorable, and the prospect of faster economic growth this year has buttressed optimistic earnings forecasts. Nonetheless, we believe that with the bulk of the extraordinarily good economic news likely now behind us, the stock market is at least close to topping out. Given the new policy assumptions in this forecast, we now anticipate a somewhat larger correction in share prices in 1998. But we still do not foresee the emergence of a major bear market, and thus the changes in the level of wealth and the cost of equity capital are not so great as to cut deeply into aggregate demand.

Credit supply conditions are not expected to exert any meaningful incremental restraint on the expansion of economic activity over the forecast period. Banks already have selectively tightened their standards on credit-card and certain other lending to higher-risk borrowers, and some further adjustments in both terms and qualification standards are likely as delinquencies on these accounts rise. However, for the vast majority of households, credit is still readily available. For businesses, credit remains relatively easy to obtain at low cost. Banks continue to compete aggressively for new loans, and capital market yield spreads remain quite narrow in historical perspective; the forecast does not suggest grounds for anticipating events that would greatly heighten concerns about business credit quality.

There have been a number of important developments in the fiscal arena since the last Greenbook. The President put his budget proposal on the table in early February, and the initial congressional reaction was less antagonistic than it has been at times in the past. However, the tenor of the discussion subsequently deteriorated, with the CBO judging the Administration numbers to be too optimistic and the Administration showing no enthusiasm for taking on the COLA issue. Prospects for agreement on a solid, multiyear, balanced budget plan are widely viewed as having diminished.

In any event, we have revised our fiscal assumptions to move closer to the pattern of the Administration plan, and they now involve $14 billion less in deficit-reduction actions in fiscal 1998 than in the January Greenbook and $26 billion less in fiscal 1999. Our new package includes an extension of discretionary spending caps beyond fiscal 1998, cutbacks in Medicare and Medicaid spending similar to the President's proposals, as well as sales of spectrum rights and other assets in the out years; we have built in a small net reduction in taxes, including the President's child tax credit. On balance, fiscal policy is expected to be only modestly restrictive over the forecast period, imposing less restraint on aggregate demand than in the January Greenbook.

While we have incorporated less deficit-reducing policy action in our current forecast, the upside surprise in economic activity has had an offsetting effect on the outlook for the federal budget. The unified deficit is projected to edge down to $101 billion in fiscal 1997 (from $107 billion in fiscal 1996) and to move up to $119 billion in fiscal 1998; the corresponding figures in the January Greenbook were $109 billion and $117 billion.

The dollar has continued to be stronger on exchange markets than we anticipated. Its trade-weighted value against other G-10 currencies has risen nearly 8 percent since the end of 1996 and is expected to remain around its current level through most of this year. Much of this appreciation has occurred against the currencies of continental Europe and may reflect increasing uncertainty surrounding the prospects for EMU. Viewed from a longer-term perspective, the dollar seems overvalued relative to the levels that would be needed to generate improvement in the U.S. current account balance, and we continue to anticipate that at some point during the projection period the trend toward greater deficits will weigh on market sentiment, contributing to some reversal of the dollar rally. However, with the tighter monetary and easier fiscal conditions in this forecast, the dollar declines only slightly next year and remains above the prior path throughout the projection period.

Summary of the Near-Term Outlook for Real GDP
(Percent change at annual rate except as noted)

Measure	1996:Q4 Jan. GB	1996:Q4 Mar. GB	1997:Q1 Jan. GB	1997:Q1 Mar. GB
Real GDP	3.5	4.3	1.7	3.4
Consumer spending	3.0	3.6	3.5	5.0
Business fixed investment	2.7	5.4	6.0	7.6
Residential structures	-8.3	-.3	-6.6	.9
Government spending	1.5	-.4	-2.0	1.2
	Change in billions of chained (1992) dollars			
Inventory investment	-5.0	-17.0	7.0	8.2
Net exports	29.4	39.3	-23.1	-27.1

Economic activity abroad accelerated at the end of last year, and we are projecting foreign real GDP to rise around 4 percent in 1997 and 1998--similar to the pace in 1996. Oil prices have declined more sharply than expected in the first quarter, reflecting unseasonably warm weather in many parts of the Northern hemisphere and some increase in world supply. The spot price of WTI will average about $22.50 per barrel in the first quarter--$1.50 less than in the January Greenbook. The price is expected to edge below $20 in the second quarter and to remain near $19.50 per barrel over the balance of the forecast period.

Recent Developments and the Outlook for the Current Quarter

Our point prediction for real GDP growth in the current quarter is 3-1/2 percent at an annual rate--down from the 4-1/4 percent growth that we now estimate for the fourth quarter. The recent behavior of the labor market certainly appears to be indicating a continuation of a strong output trend. Most notably, private payrolls expanded briskly in the first two months of the year, even after making allowances for the possible distortions of the reported figures resulting from weather and seasonal adjustment problems. And the low level of initial claims for jobless benefits suggests that the strength in hiring has carried into March.

On the expenditure side, there are many important holes in the available current-quarter data. It is fairly clear, however, that personal consumption expenditures will post a large increase, probably in the vicinity of 5 percent (annual rate). Sales of light vehicles are up, and non-auto retail sales have risen sharply in the past two months. A hefty increase in labor income has supported demand, but it may also be that we are seeing some response to the huge accretion of stock market wealth. The willingness of households to spend likely has been bolstered by the more positive perceptions of employment prospects revealed in recent surveys--perceptions that may also explain the rise in labor force participation that has helped to stabilize the unemployment rate in the face of the rapidly growing demand for workers.

Single-family housing starts averaged 1.17 million units (annual rate) in January and February, well above the fourth-quarter level. Although strength in this sector is not surprising in light of the prevailing economic and financial conditions, activity probably was boosted significantly by favorable weather, which permitted a catch-up for production delayed by rains in December and an early start on work that might otherwise have begun in March. Meanwhile, the jump in multifamily starts in February only partially offset an odd plunge in January, and we expect such starts to average 300,000 units in the current quarter--short of the fall pace. On balance, residential investment outlays probably will rise slightly this quarter.

Business capital spending seems to be on track for a substantial increase. Recent trends in orders and shipments suggest a further sizable gain in outlays for real producers' durable equipment, led by ongoing strength in purchases of computers and with some further increase in communications equipment. Outside of these areas, spending on motor vehicles and other less-high-tech equipment looks to be flat. Regarding nonresidential construction, the trends in contracts have remained favorable for most market segments, and construction put in place rose in January to a level well above the average of the fourth quarter.

A key element in the GDP forecast for the current quarter is the anticipated unwinding of the special factors that boosted real net exports in the fourth quarter: residual seasonality in the data, a bunching in exports, and the auto strikes. In addition, the rapid growth in domestic demand also is projected to be partially absorbed by increased imports of goods and services. All told, the deterioration in real net exports may hold down real GDP growth by 1-1/2 percentage points in the first quarter, after boosting growth 2-1/4 percentage points in the fourth quarter of 1996.

Stocks have become quite lean in a number of sectors, and a near-term step-up in business inventory investment appears likely. Manufacturing and trade inventories were up modestly in January, and with manufacturing output projected to increase at a 4 percent annual rate this quarter, some additional inventory investment is expected in February and March. Overall, we have nonfarm inventories rising at a 2-1/2 percent annual rate in the first quarter, contributing about 1/3 percentage point to real GDP growth.

The latest news on inflation has been favorable. There have been no signs of inflation in finished goods prices at the producer level for many months, and the CPI rose an average of 0.2 percent per month in January and February. Food prices have risen moderately, although higher raw coffee prices will begin to be felt in retail prices in March. Retail energy prices are beginning to respond to the decline in crude oil costs and substantial declines are anticipated in coming months. Excluding food and energy, the CPI rose only 0.1 percent in January and 0.2 percent in February; assuming another 0.2 percent increase in March, core consumer prices would increase at only a 2-1/4 percent annual rate in the first quarter. On the wage front, average hourly earnings edged up 0.2 percent in January and February, following larger increases in the fourth quarter of 1996 that were related in part to the increase in the minimum wage. Over the past twelve months, average hourly earnings have risen 3.8 percent--about 3/4 percent higher than in the year-earlier period.

The Outlook for the Economy beyond the Current Quarter

Reflecting mainly the upside surprise in the first quarter, we have raised our forecast of real GDP growth in 1997 by 1/2 percentage point to 2-3/4 percent. The projected growth rate for 1998--at just over 2 percent--is the same as the January Greenbook, as higher real interest rates and the higher dollar offset the multiplier-accelerator effects of the added growth this year and a less restrictive fiscal stance. In light of the recent favorable behavior of prices, including the continuing significant downward tilt of import prices, we have lowered the forecast of CPI inflation through the first half of this year, but there has been no material change in our projection of core or total inflation in 1998.

Consumer spending. Real PCE is forecast to rise 3-1/2 percent over the four quarters of 1997 and another 2-1/2 percent in 1998--just slightly exceeding the growth of real disposable personal income. We continue to believe that the run-up in household net worth over the past few years ought to be boosting consumption. And it may indeed be doing so, explaining some of the reported strength in spending in upscale retail markets. Yet, there are only the faintest hints that, in the aggregate, the household sector has been inclined to spend a greater proportion of its income. Possibly, future revisions of the national income accounts will alter this picture, but for now it remains our working assumption that there simply have been other factors offsetting the wealth effect.

Increased debt-service burdens, especially among households with below-average incomes, are one of these. Rising delinquencies suggest that many consumers have gotten in over their heads, and though a sizable number have been finding relief from their debt obligations through resort to bankruptcy, they may be feeling more constrained in their spending now. Probably more important in explaining the updrift in the personal saving rate over the past two years is the likelihood that the acceleration in income and the surge in wealth has not yet been fully incorporated in people's perceptions of their permanent income. Another possibility that we have noted repeatedly is that there may be an increased desire to save for retirement. Discussion of the problems of the social security and Medicare systems has reinforced the already increased attention given in the media and elsewhere to the widespread inadequacy of personal provision for retirement income. The baby-boom generation is now in its prime asset-accumulation years, and the bull market in equities has provided an extra incentive to save.

We continue to believe, however, that the marked run-up in the household wealth-to-income ratio over the past couple of years carries with it the potential for a considerable elevation of spending, and that this is one of the major upside risks to aggregate demand in the near term. Of course, one might also reason that a deeper stock market setback than we have anticipated in this forecast could have a significant adverse effect on the sense of well-being of many families, with contractionary effects on spending.

Residential investment. Housing construction is expected to drift down over coming quarters, reflecting moderating growth in employment and the projected rise in mortgage rates. Total housing starts, which were 1.47 million units in 1996, are forecast to fall to 1.41 million in 1997 and 1.34 million in 1998. Some slippage is expected in multifamily starts, but the bulk of the decline is likely to occur in the single-family segment, with these starts falling to a 1.12 million unit pace this year and 1.06 million units in 1998.

These are still quite healthy levels of construction by historical standards. We believe that the combination of strong job gains over the past few years, the large gain in stock market wealth, and the favorable cash-flow affordability of home ownership bodes well for demand in the single-family market. Consumers' assessments of homebuying conditions, as revealed in the preliminary March Michigan SRC survey, are decidedly upbeat; the good economic conditions are cited as a favorable factor. Until short-term rates rise, many homebuyers will seek refuge from the upturn in long-term rates by utilizing adjustable-rate loans. But as short-term rates do turn up in 1998, it should put a further damper on demand.

Business fixed investment. Real business fixed investment is projected to decelerate over the forecast period, rising 7-1/4 percent in 1997 and 5-3/4 percent in 1998. Among the components of BFI, there are sharply different trends. Real PDE is forecast to rise 7-1/2 percent this year and 6-1/4 percent in 1998. Much of this increase will be accounted for by spending on office and computing equipment. Rapid technological progress, steep price declines, and an ongoing need to update facilities are sustaining this rapid growth. In addition, spending on telecommunications equipment probably will rise appreciably, reflecting, among other things, the growth of the Internet and deregulation of the telecommunications industry. In contrast, we expect investment in other types of equipment to level off, in response to waning accelerator effects, flattening internal cash flow, and already substantial manufacturing capacity growth.

After a larger increase in 1996, real investment in nonresidential structures is expected to rise 6-1/2 percent this year and another 4-1/2 percent in 1998. Strength is indicated in a number of market segments, but perhaps most notable is the commercial sector. A wave of building appears to be in train in the lodging industry, and we seem to be at the start of a resurgence in office construction. Vacancy rates for hotel rooms and office space have fallen to low levels, and rents and property values are rising. Financing for new projects is readily available from pension funds, REITs, and commercial mortgage-backed securities; speculative projects are again on the rise.

Inventory investment. Throughout this expansion, businesses have attempted to economize as much as possible on their holdings of inventories. Although we expect this tendency to continue, inventory-sales ratios are now quite low, and we expect that businesses will want to add significantly to their stocks over coming quarters. Thus, after an increase of 1-3/4 percent in 1996, nonfarm inventories are projected to rise 2-3/4 percent in 1997, and we expect to see similar growth in 1998.

We are anticipating some modest rebuilding of farm inventories. With normal harvests, real crop inventories should grow moderately. In contrast, livestock herds may continue to decline--although at a slower pace than in 1996.

Government. Real federal consumption and gross investment expenditures should fall 1-1/2 percent in 1997 and another 3-3/4 percent in 1998. Cutbacks this year are spread fairly evenly across defense and nondefense categories, while in 1998 the bulk of the declines is in defense.

Real purchases by state and local governments are projected to rise about 2-1/2 percent per annum in 1997 and 1998. Although many state and local governments enjoy quite favorable financial conditions at the moment, ongoing initiatives to cut taxes are expected to continue restraining spending. State and local compensation is projected to grow only 1-1/2 percent per year, but the need for more schools, prisons, and general infrastructure is expected to generate increases in construction spending of between 4 and 5 percent over the next two years.

Net exports of goods and services. After a 7-1/2 percent increase in 1996, growth in real exports of goods and services is projected to average 6-1/4 percent over the next two years, reflecting the appreciation of the dollar. With the strength in domestic demand in 1997, real imports are forecast to rise almost 11 percent this year but to fall off to a 7-3/4 percent pace in 1998. On balance, the additional deterioration in real net exports takes 3/4 percentage point off the growth of real GDP in 1997 and 1/3 percentage point in 1998. (A more detailed discussion of the prospects for the external sector is contained in the *International Developments* section.)

Labor markets. Gains in nonfarm payrolls are expected to remain robust this year--averaging 210,000 per month--and then slow to 140,000 per month in 1998 as the pace of economic activity moderates. The buoyancy of the labor market has been drawing people into the labor force--a pattern that should continue. The participation rate, which was 66.9 percent in the fourth quarter, is projected to increase to 67-1/4 percent by the end of 1998. The continued strength of the economic expansion is the driving force behind this increase, but the jobs requirement of the welfare reform legislation could make a small contribution as well.

Our forecast of labor productivity growth is essentially unchanged from the January Greenbook. As before, we view our productivity forecast as a compromise between a literal reading of the incoming data and a skepticism that trend productivity growth could have been so slow in the past few years. Indeed, looking at the apparent increases in capital per worker and the advances in technology, one might think that there would have been an acceleration in the trend in output per hour. Our compromise nods in the direction of the income side of the NIPAs, which shows considerably faster "output" growth than does the expenditure side. We have assumed a significant upward revision to the recent level of nonfarm business output and an

The Outlook for the Labor Market
(Percent change, Q4 to Q4, except as noted)

Measure	1995	1996	1997	1998
Output per hour, nonfarm business	-.1	1.0	.9	.8
Previous	-.1	.8	.8	.8
Nonfarm payroll employment	2.0	2.2	2.1	1.4
Previous	2.0	2.2	1.7	1.4
Labor force participation rate[1]	66.5	66.9	67.1	67.2
Previous	66.5	66.9	67.1	67.2
Unemployment rate	5.6	5.3	5.0	4.9
Previous	5.6	5.3	5.1	5.0

1. Percent, average for the fourth quarter.

underlying productivity growth trend of just over 1 percent per year (0.9 percent on a pure chain-weighted basis) going forward.

Under these assumptions, productivity grows slightly below trend in 1997 and 1998--a typical pattern late in a business cycle expansion. While we do not think that there has been a "stocking up" of workers who will be unneeded as output decelerates, there have been numerous reports of declining worker quality and the need for remedial training programs.

Wages and prices. With the unemployment rate falling still further, we expect the growth in ECI hourly compensation to pick up gradually over the forecast period--rising from 3.1 percent in 1996 to 3.5 percent in 1997 and 3.7 percent in 1998. To date, the tightness in labor markets has shown through most clearly in wages and salaries, which accelerated considerably last year. We expect a further pickup in wage inflation over the next two years, but the projected increases in the size of compensation gains also include bigger increments in benefits costs--particularly in the medical insurance area.

The year-to-year pattern of compensation increases reflects a couple of factors likely to influence wages especially. The first is last year's faster CPI increase, which probably has not shown through fully as yet, given the tendency of many employers to look backward in granting annual wage adjustments. The rise in the federal minimum wage this summer will give a further modest boost to wage rates, with the impulse largely showing up by year-end. Our expectation that the CPI will decelerate this year (as food and energy prices ease) points to smaller cost-of-living catch-ups in 1998.

Staff Inflation Projections
(Percent change, Q4 to Q4, except as noted)

Measure	1995	1996	1997	1998
Consumer price index	2.6	3.2	2.5	3.0
Previous	2.7	3.1	2.6	3.0
Food	2.6	4.2	2.3	2.9
Previous	2.6	4.2	2.4	2.9
Energy	-1.6	7.6	.0	.9
Previous	-1.7	7.4	.8	.6
Excluding food and energy	3.0	2.6	2.8	3.2
Previous	3.0	2.6	2.8	3.2
GDP chain price index	2.5	2.1	2.5	2.8
Previous	2.5	2.2	2.6	2.8
ECI for compensation of private industry workers[1]	2.6	3.1	3.5	3.7
Previous	2.6	3.1	3.5	3.7
Prices of non-oil merchandise imports	.8	-2.8	-.3	.2
Previous	.8	-3.0	-1.0	1.9
	Percentage points			
MEMO				
Adjustment to the core CPI for technical changes	.1	.2	.3	.4

1. December to December.

On the benefits side, the anecdotal evidence suggests that some employers are using insurance or other nonwage inducements in their efforts to attract and retain workers. In addition, there are indications that the underwriting cycle is turning in the medical insurance business, with premiums firming after a period of aggressive competition. The boom in the stock market has reduced the funding requirements of many firms with defined benefit pension plans, but defined contribution plans are becoming more prevalent, and employer contributions would in any event tend to rise automatically with wages and salaries--as would some other benefit costs.

We also are projecting a substantial deterioration in the underlying rate of price inflation over the next year or so. In the near term, the appreciation of the dollar will continue to hold down inflation both by reducing the cost of imported consumer goods and by increasing competitive pressures on domestic producers. In addition, manufacturers currently have ample plant capacity, and the bottlenecks that in the past typically added to price pressures as economic expansions lengthened are absent in this cycle. Both of these influences are expected to induce some squeezing in firms' profit margins this year as they are unable to fully pass along all of their cost increases. But with labor markets remaining tight, we expect the uptrend in labor costs eventually to show up in a materially higher rate of core price increases--that tendency being reinforced next year by the anticipated softening of the dollar and an associated firming in non-oil import prices.

The overall performance of the CPI should be more favorable, reflecting positive developments in the food and energy sectors. After rising more than 4 percent in 1996, consumer food prices are projected to increase only about 2-1/4 percent this year and 3 percent in 1998. Agricultural supply conditions are expected to continue to improve, assuming normal harvests this year and next. Prices accelerate a bit in 1998, as a cyclical liquidation of the cattle herd drives up beef prices.

After rising substantially in 1996, consumer energy prices are projected to flatten out in 1997 and to rise only a little in 1998. The decline in world crude oil prices since December now is starting to show up at the retail level. With stocks rebuilt to more normal levels, heating oil prices are dropping sharply. Relatively low inventories of gasoline--reflecting the need earlier in the winter to boost production of heating oil--have supported gas prices recently. But the lower crude costs are finally beginning to push prices down at the pump; we are expecting double-digit (annual) rates of declines in gas prices this spring and some further easing during the summer.

Financial Markets

Concerns sounded by Chairman Greenspan and others about investors' incaution seem to have reinforced the tinge of acrophobia that had already been creeping into the markets as stock prices soared to ever greater heights. But absent clear indications that profits are flagging or that interest rates are headed higher, elevated stock valuations seem likely to persist. Meanwhile, yield spreads of private debt securities over comparable Treasuries are tight by historical standards, and overall supply conditions in credit markets are expected to remain generally favorable over the forecast period.

Growth of total domestic nonfinancial sector debt is projected at a shade above 5 percent in 1997 and 1998--about in line with that of nominal GDP. Governmental debt growth is likely to be at only half that pace. Federal borrowing needs are expected to remain subdued, and net issuance of state and local government debt is also projected to be quite modest. Retirements of tax-exempt debt have trended down relative to the pace of recent years, but they will nonetheless remain a drag on the growth of state and local government debt. In addition, with long-term interest rates expected to rise, the volume of new bonds issued for advance refundings should remain quite low.

In the household sector, supply conditions may impose a modest degree of restraint on debt expansion. Many banks have tightened their terms and standards on consumer loans--especially credit cards--in response to significant increases in delinquency rates and charge-offs. On the other hand, however, the strength in home mortgage debt in the past year appears to have reflected, in part, some substitution away from traditional consumer credit in favor of home equity loans. Lenders have encouraged this shift by offering home equity lines on attractive terms and by promoting the use of such loans as a means of consolidating debts. On balance, household debt is expected to grow about 6-1/4 percent this year and a touch slower in 1998--both well below the pace of recent years--as debt-service burdens climb and as lenders become a bit more cautious.

In the business sector, capital expenditures are projected to remain strong while rising real wages are mirrored in a flattening of profits and internal funds of nonfinancial corporations. As a result, the corporate financing gap is expected to widen considerably this year and next. In addition, business borrowing will be bolstered by robust merger activity.

Bond issuance is likely to remain substantial, but in light of the projected rise in interest rates, there likely will be a bit more reliance on short-term borrowings. Net issuance of commercial paper is projected to strengthen considerably, and business loans at banks should increase appreciably.

The strength of business credit demands is projected to contribute to only a modest pickup in overall depository credit growth. Bank credit probably will expand at a moderate rate over this year and next. Similarly, the continued recovery of the savings and loan industry is projected to result in a steady rise in thrift credit.

The anticipated moderate advance in depository credit is not expected to cause banks to bid more aggressively for retail deposits. As a result, deposit liabilities in M2 may expand sluggishly over the forecast period. Overall M2 growth may be slightly below nominal GDP growth over the forecast period, in part reflecting the rise in short-term interest rates next year. A decline in stock prices (or even less rapid increases) could provide some support for M2 next year. With banks relying heavily on large time deposits and other managed liabilities to fund asset growth, M3 growth is expected to exceed that of M2 through 1998.

Alternative Simulations

We have run two alternative model simulations, based on different paths for the federal funds rate. In the first, the federal funds rate is held at 5-1/4 percent next year. Real short-term interest rates decline under this assumption, giving a slight boost to activity. Real GDP grows almost 1/4 percentage point faster than in the baseline, and the unemployment rate falls to 4.8 percent. Given the lags involved, there is no effect on inflation in 1998, but the higher levels of resource utilization would cause some added deterioration in inflation performance beyond the forecast horizon.

Alternative Federal Funds Rate Assumptions
(Percent change, Q4 to Q4, except as noted)

Measure	1996	1997	1998
Real GDP			
Baseline	3.2	2.8	2.1
No change	3.2	2.8	2.3
Tighter policy	3.2	2.5	1.2
Civilian unemployment rate[1]			
Baseline	5.3	5.0	4.9
No change	5.3	5.0	4.8
Tighter policy	5.3	5.1	5.4
CPI			
Baseline	3.2	2.5	3.0
No change	3.2	2.5	3.0
Tighter policy	3.2	2.4	2.6

1. Average for the fourth quarter.

In the second alternative, the federal funds rate raised to 6-1/2 percent by the end of the year and remains at that level through 1998. In this scenario, real GDP growth is about 1/4 percentage point lower than the baseline in 1997 and 1 percentage point less in 1998. The unemployment rate only falls to 5.1 percent by the end of this year and moves back up to almost 5-1/2 percent by the end of 1998. The rate of increase in consumer prices is just 0.1 percentage point lower in 1997 but almost 1/2 percentage point less than baseline in 1998. On this trajectory, the economy would begin to develop enough slack during 1999 to set the stage for a resumption of a disinflationary trend; some trimming of the funds rate might in turn be required to restore growth to a moderate track.

Strictly Confidential <FR>
Class II FOMC

March 19, 1997

STAFF PROJECTIONS OF CHANGES IN GDP, PRICES, AND UNEMPLOYMENT
(Percent, annual rate)

Interval		Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		01/29/97	03/19/97	01/29/97	03/19/97	01/29/97	03/19/97	01/29/97	03/19/97	01/29/97	03/19/97
ANNUAL											
1994		5.8	5.8	3.5	3.5	2.3	2.3	2.6	2.6	6.1	6.1
1995		4.6	4.6	2.0	2.0	2.5	2.5	2.8	2.8	5.6	5.6
1996		4.5	4.5	2.4	2.5	2.2	2.1	2.9	2.9	5.4	5.4
1997		4.9	5.4	2.5	3.2	2.6	2.4	2.8	2.7	5.1	5.1
1998		4.6	4.6	2.2	2.3	2.6	2.6	2.8	2.8	5.0	4.9
QUARTERLY											
1995	Q1	3.8	3.8	0.4	0.4	3.3	3.3	2.7	2.7	5.5	5.5
	Q2	3.1	3.1	0.7	0.7	2.4	2.4	3.5	3.5	5.6	5.6
	Q3	6.0	6.0	3.8	3.8	2.1	2.1	2.1	2.1	5.7	5.7
	Q4	2.3	2.3	0.3	0.3	2.1	2.1	2.4	2.4	5.6	5.6
1996	Q1	4.2	4.2	2.0	2.0	2.3	2.3	3.2	3.2	5.6	5.6
	Q2	6.5	6.5	4.7	4.7	2.2	2.2	3.9	3.9	5.4	5.4
	Q3	3.8	3.8	2.1	2.1	2.0	2.0	2.3	2.3	5.3	5.3
	Q4	5.9	5.5	3.5	4.3	2.5	1.8	3.1	3.1	5.3	5.3
1997	Q1	4.6	6.4	1.7	3.4	3.2	3.1	3.1	2.5	5.2	5.3
	Q2	4.9	5.3	2.4	2.9	2.7	2.5	2.3	2.1	5.1	5.1
	Q3	4.4	4.5	2.4	2.5	2.2	2.2	2.3	2.6	5.1	5.0
	Q4	4.6	4.4	2.4	2.4	2.3	2.2	2.8	2.9	5.1	5.0
1998	Q1	4.6	4.8	2.2	2.3	2.8	2.7	2.9	2.9	5.1	4.9
	Q2	4.5	4.6	2.1	2.1	2.7	2.8	2.9	2.9	5.0	4.9
	Q3	4.5	4.6	2.1	2.0	2.8	2.9	3.0	3.0	5.0	4.9
	Q4	4.7	4.6	2.0	2.0	2.9	2.9	3.1	3.1	5.0	4.9
TWO-QUARTER[3]											
1995	Q2	3.5	3.5	0.6	0.6	2.9	2.9	3.2	3.0	0.0	0.0
	Q4	4.1	4.1	2.0	2.0	2.1	2.1	2.2	2.3	0.0	0.0
1996	Q2	5.4	5.4	3.3	3.3	2.2	2.2	3.5	3.4	-0.2	-0.2
	Q4	4.9	4.6	2.8	3.2	2.2	1.9	2.7	3.0	-0.1	-0.1
1997	Q2	4.8	5.9	2.1	3.1	2.9	2.8	2.7	2.3	-0.2	-0.2
	Q4	4.5	4.4	2.4	2.5	2.3	2.2	2.6	2.7	-0.0	-0.1
1998	Q2	4.6	4.7	2.1	2.2	2.7	2.8	2.9	2.9	-0.1	-0.1
	Q4	4.6	4.6	2.1	2.0	2.8	2.9	3.1	3.0	-0.0	-0.0
FOUR-QUARTER[4]											
1994	Q4	5.9	5.9	3.5	3.5	2.3	2.3	2.6	2.7	-1.0	-1.0
1995	Q4	3.8	3.8	1.3	1.3	2.5	2.5	2.7	2.6	0.0	0.0
1996	Q4	5.1	5.0	3.1	3.2	2.2	2.1	3.1	3.2	-0.3	-0.3
1997	Q4	4.6	5.2	2.3	2.8	2.6	2.5	2.6	2.5	-0.2	-0.3
1998	Q4	4.6	4.7	2.1	2.1	2.8	2.8	3.0	3.0	-0.1	-0.1

1. For all urban consumers.
2. Level, except as noted.
3. Percent change from two quarters earlier; for unemployment rate, change in percentage points.
4. Percent change from four quarters earlier; for unemployment rate, change in percentage points.

Strictly Confidential <FR>
Class II FOMC

REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, ANNUAL VALUES
(Seasonally adjusted annual rate)

March 19, 1997

Item	Units[1]	1990	1991	1992	1993	1994	1995	1996	1997	1998
								- - - Projected	- - -	
EXPENDITURES										
Nominal GDP	Bill. $	5743.8	5916.7	6244.4	6553.0	6935.7	7253.8	7576.6	7982.0	8352.4
Real GDP	Bill. Ch. $	6138.7	6079.0	6244.4	6386.4	6608.7	6742.9	6909.1	7130.8	7294.1
Real GDP	% change	-0.2	0.4	3.7	2.2	3.5	1.3	3.2	2.8	2.1
Gross domestic purchases		-0.8	-0.0	4.0	2.9	3.8	1.0	3.4	3.5	2.4
Final sales		0.6	-0.4	3.9	2.0	2.9	1.9	3.2	2.7	2.0
Priv. dom. final purchases		-0.6	-0.8	4.9	3.5	4.0	2.3	3.7	3.9	2.8
Personal cons. expenditures		0.5	-0.2	4.2	2.5	3.1	1.9	2.7	3.5	2.5
Durables		-3.2	-3.1	9.4	7.3	7.0	1.3	5.3	6.6	3.7
Nondurables		-0.5	-1.0	3.4	1.5	3.5	1.1	1.8	3.5	2.4
Services		2.0	0.9	3.6	2.1	2.0	2.4	2.7	2.8	2.3
Business fixed investment		-2.5	-6.0	5.5	8.5	10.1	6.4	9.5	7.3	5.7
Producers' dur. equipment		-2.0	-2.6	9.6	11.5	12.6	6.9	9.7	7.6	6.2
Nonres. structures		-3.5	-12.5	-3.4	1.6	3.6	5.1	8.6	6.5	4.4
Residential structures		-15.1	1.1	16.9	8.1	5.7	-1.5	4.2	-0.2	-1.2
Exports		7.2	8.6	4.1	4.8	9.9	7.4	7.5	6.1	6.5
Imports		0.5	4.1	7.4	10.5	11.8	4.2	8.3	11.0	7.8
Gov't. cons. & investment		2.6	-0.7	1.7	-0.5	0.0	-1.3	2.0	1.0	0.2
Federal		1.6	-3.1	1.3	-5.4	-3.1	-6.7	1.6	-1.5	-3.8
Defense		0.3	-5.3	-1.3	-6.8	-5.7	-6.8	0.1	-1.4	-4.1
State & local		3.3	1.0	2.0	3.1	2.2	2.1	2.2	2.6	2.4
Change in bus. inventories	Bill. Ch. $	10.4	-3.0	7.3	19.1	58.9	33.1	14.0	30.8	33.3
Nonfarm		7.8	-1.2	1.9	26.4	46.8	37.2	17.2	30.3	31.4
Net exports		-61.9	-22.3	-29.5	-72.0	-105.7	-107.6	-113.6	-141.6	-167.6
Nominal GDP	% change	4.4	3.8	6.3	4.8	5.9	3.8	5.0	5.2	4.7
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	109.4	108.3	108.6	110.7	114.2	117.2	119.5	122.2	124.1
Unemployment rate	%	5.6	6.8	7.5	6.9	6.1	5.6	5.4	5.1	4.9
Industrial prod. index	% change	-0.6	-0.0	3.9	3.0	5.7	1.8	3.9	3.4	2.2
Capacity util. rate - mfg.	%	81.4	78.0	79.5	80.8	83.1	83.1	82.1	82.3	82.3
Housing starts	Millions	1.19	1.01	1.20	1.29	1.46	1.35	1.47	1.41	1.34
Light motor vehicle sales		14.05	12.52	12.85	13.87	15.02	14.77	15.03	15.05	14.91
North Amer. produced		10.85	9.74	10.51	11.72	12.88	12.85	13.32	13.20	13.14
Other		3.20	2.77	2.34	2.15	2.13	1.91	1.70	1.85	1.77
INCOME AND SAVING										
Nominal GNP	Bill. $	5764.9	5932.4	6255.5	6563.5	6931.9	7246.7	7567.7	7962.0	8321.2
Nominal GNP	% change	4.6	3.5	6.2	4.7	5.7	3.9	4.9	5.0	4.5
Nominal personal income		6.4	3.7	7.3	3.6	5.2	5.6	5.7	5.1	5.1
Real disposable income		1.0	0.8	4.0	0.9	2.7	3.1	2.7	3.2	2.5
Personal saving rate	%	5.0	5.7	5.9	4.5	3.8	4.7	4.9	5.0	4.9
Corp. profits, IVA & CCAdj.	% change	6.2	3.9	12.7	19.9	11.3	7.2	7.6	4.5	2.2
Profit share of GNP	%	6.4	6.4	6.4	7.1	7.6	8.1	8.7	8.7	8.4
Excluding FR Banks	%	6.0	6.1	6.1	6.8	7.4	7.8	8.4	8.5	8.2
Federal surpl./deficit	Bill. $	-154.7	-196.0	-280.9	-255.6	-190.2	-161.7	-125.8	-119.3	-124.2
State & local surpl./def.		80.1	75.8	86.3	94.9	99.7	95.0	92.9	92.9	87.6
Ex. social ins. funds		20.2	11.5	18.3	28.0	36.9	36.8	37.2	39.5	35.0
PRICES AND COSTS										
GDP implicit deflator	% change	4.6	3.4	2.6	2.5	2.3	2.5	1.7	2.3	2.5
GDP chn.-wt. price index		4.7	3.3	2.6	2.5	2.3	2.5	2.1	2.5	2.8
Gross Domestic Purchases chn.-wt. price index		5.2	2.7	2.7	2.3	2.4	2.3	2.2	2.2	2.7
CPI		6.3	3.0	3.1	2.7	2.7	2.6	3.2	2.5	3.0
Ex. food and energy		5.3	4.4	3.5	3.1	2.8	3.0	2.6	2.8	3.2
ECI, hourly compensation[2]		4.6	4.4	3.5	3.6	3.1	2.6	3.1	3.5	3.7
Nonfarm business sector										
Output per hour		-0.6	2.2	3.6	-0.3	0.3	-0.1	1.0	0.9	0.8
Compensation per Hour		5.8	4.8	4.6	1.8	2.3	3.7	3.6	3.6	3.7
Unit labor cost		6.4	2.5	1.0	2.1	2.0	3.7	2.6	2.7	2.9

1. Changes are from fourth quarter to fourth quarter.
2. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES
(Seasonally adjusted, annual rate except as noted)

March 19, 1997

Item	Units	1994 Q1	1994 Q2	1994 Q3	1994 Q4	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2
EXPENDITURES											
Nominal GDP	Bill. $	6776.0	6890.5	6993.1	7083.2	7149.8	7204.9	7309.8	7350.6	7426.8	7545.1
Real GDP	Bill. Ch. $	6508.5	6587.6	6644.9	6693.9	6701.0	6713.5	6776.4	6780.7	6814.3	6892.6
Real GDP	% change	2.5	4.9	3.5	3.0	0.4	0.7	3.8	0.3	2.0	4.7
Gross domestic purchases		3.5	5.3	3.7	2.5	1.4	0.7	2.6	-0.7	3.0	5.2
Final sales		1.2	3.0	4.2	3.5	0.6	2.1	3.6	1.4	3.0	4.1
Priv. dom. final purchases		3.9	4.4	3.8	4.0	2.3	2.3	3.0	1.4	4.7	4.1
Personal cons. expenditures		2.8	3.5	2.8	3.1	1.0	3.1	2.4	1.1	3.5	3.4
Durables		5.8	4.3	5.6	12.4	-8.9	7.0	9.3	-1.0	8.2	11.4
Nondurables		3.9	3.2	3.8	3.2	2.4	1.8	0.5	-0.4	3.7	1.3
Services		1.6	3.5	1.6	1.2	2.4	3.0	2.0	2.3	2.4	2.7
Business fixed investment		7.3	7.1	13.8	12.2	15.4	3.5	4.9	2.5	11.6	3.8
Producers' dur. equipment		15.5	4.1	19.4	11.9	17.4	3.5	4.3	3.0	13.1	6.7
Nonres. structures		-11.8	15.7	0.2	13.0	9.9	3.4	6.3	1.0	7.7	-3.7
Residential structures		12.8	12.7	-1.8	-0.1	-6.3	-13.4	9.2	6.4	7.4	16.3
Exports		-1.5	15.9	9.7	16.5	2.6	5.9	10.7	10.7	1.8	5.6
Imports		8.2	18.4	10.7	10.3	11.2	4.5	-0.0	1.6	10.6	9.9
Gov't. cons. & investment		-4.3	-0.8	7.0	-1.4	-1.2	0.8	-0.6	-4.3	1.6	7.7
Federal		-11.4	-5.3	11.5	-5.9	-6.5	-1.4	-5.6	-13.2	6.0	9.4
Defense		-17.4	0.7	13.5	-16.1	-7.4	0.6	-7.6	-12.3	4.1	10.0
State & local		0.7	2.2	4.2	1.6	2.3	2.1	2.7	1.5	-0.9	6.7
Change in bus. inventories	Bill. Ch. $	40.5	74.5	64.5	56.1	54.5	30.5	33.0	14.6	-3.0	7.1
Nonfarm		29.7	54.0	50.5	53.0	57.4	33.7	38.6	19.0	2.9	11.7
Net exports		-99.3	-107.3	-111.7	-104.3	-122.5	-121.4	-101.6	-84.9	-104.0	-114.7
Nominal GDP	% change	5.3	6.9	6.1	5.3	3.8	3.1	6.0	2.3	4.2	6.5
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	112.6	113.7	114.7	115.6	116.5	117.0	117.4	117.9	118.5	119.3
Unemployment rate	%	6.6	6.2	6.0	5.6	5.5	5.6	5.7	5.6	5.6	5.4
Industrial prod. index	% change	6.2	6.7	4.4	5.6	3.9	-0.7	3.2	0.8	1.6	6.2
Capacity util. rate - mfg.	%	82.0	83.0	83.3	84.0	84.2	83.1	82.9	82.3	81.7	82.1
Housing starts	Millions	1.39	1.47	1.45	1.47	1.32	1.29	1.42	1.41	1.46	1.50
Light motor vehicle sales		15.05	14.86	14.95	15.20	14.72	14.42	14.94	14.98	15.19	15.02
North Amer. produced		12.92	12.71	12.74	13.15	12.68	12.46	13.08	13.20	13.51	13.32
Other		2.13	2.15	2.21	2.05	2.04	1.96	1.86	1.79	1.68	1.70
INCOME AND SAVING											
Nominal GNP	Bill. $	6781.0	6888.3	6987.0	7071.4	7146.8	7202.4	7293.4	7344.3	7426.6	7537.5
Nominal GNP	% change	5.4	6.5	5.9	4.9	4.3	3.1	5.1	2.8	4.6	6.1
Nominal personal income		-3.4	13.3	4.9	6.7	7.1	4.7	4.9	5.8	4.8	6.8
Real disposable income		-5.4	9.7	2.9	4.2	3.7	0.3	4.3	4.4	2.0	1.3
Personal saving rate	%	2.7	4.0	4.1	4.3	4.9	4.1	4.5	5.2	4.8	4.3
Corp. profits, IVA & CCAdj.	% change	-35.4	82.5	14.8	13.5	-7.4	1.7	40.8	-0.5	23.6	6.8
Profit share of GNP	%	6.8	7.8	7.9	8.1	7.8	7.8	8.4	8.3	8.7	8.7
Excluding FR Banks	%	6.5	7.5	7.7	7.8	7.5	7.5	8.1	8.0	8.4	8.4
Federal surpl./deficit	Bill. $	-212.7	-169.6	-188.5	-190.1	-172.6	-161.1	-158.5	-154.5	-155.2	-126.7
State & local surpl./def.		94.8	105.2	99.6	99.3	99.0	99.0	93.9	88.1	91.0	101.0
Ex. social ins. funds		29.0	41.1	37.9	39.4	40.2	40.9	35.8	30.5	34.1	44.6
PRICES AND COSTS											
GDP implicit deflator	% change	2.8	1.9	2.5	2.2	3.4	2.4	2.1	2.0	2.2	1.8
GDP chn.-wt. price index		2.9	1.9	2.4	2.1	3.3	2.4	2.1	2.1	2.3	2.2
Gross Domestic Purchases chn.-wt. price index		2.4	2.3	3.0	2.0	2.8	2.8	1.6	1.9	2.3	2.1
CPI		1.9	2.8	3.6	2.4	2.7	3.5	2.1	2.4	3.2	3.9
Ex. food and energy		2.9	2.9	3.1	2.3	3.3	3.3	2.8	2.7	2.7	2.7
ECI, hourly compensation[1]		3.0	3.4	3.3	2.3	2.9	2.9	2.6	2.6	2.9	3.2
Nonfarm business sector											
Output per hour		-1.8	1.0	1.7	0.4	-2.3	1.5	1.8	-1.2	1.9	0.6
Compensation per hour		2.9	1.3	1.8	3.3	2.9	4.0	3.7	4.0	3.4	3.9
Unit labor cost		4.9	0.3	0.1	2.9	5.3	2.5	1.9	5.2	1.5	3.3

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES
(Seasonally adjusted, annual rate except as noted)

March 19, 1997

			- - - - - - - - - - - - - - - Projected - - - - - - - - - - - - - - -								
Item	Units	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4
EXPENDITURES											
Nominal GDP	Bill. $	7616.3	7718.3	7839.7	7941.9	8029.8	8116.5	8211.7	8305.2	8398.9	8494.0
Real GDP	Bill. Ch. $	6928.4	7001.0	7060.3	7110.1	7154.8	7198.1	7238.9	7277.1	7312.4	7348.2
Real GDP	% change	2.1	4.3	3.4	2.9	2.5	2.4	2.3	2.1	2.0	2.0
Gross domestic purchases		3.3	2.0	4.9	3.5	3.4	2.3	2.6	2.3	2.7	1.8
Final sales		0.5	5.3	2.9	2.5	2.3	2.9	2.1	2.1	1.7	2.2
Priv. dom. final purchases		2.3	3.7	5.2	3.8	3.5	3.1	2.8	2.8	2.8	2.7
Personal cons. expenditures		0.5	3.6	5.0	3.2	3.2	2.7	2.5	2.5	2.5	2.5
Durables		-2.6	4.6	12.9	4.8	5.1	3.7	3.8	3.8	3.5	3.5
Nondurables		0.4	1.7	4.9	3.2	3.2	2.7	2.3	2.3	2.4	2.4
Services		1.3	4.3	3.3	2.9	2.7	2.5	2.3	2.3	2.3	2.3
Business fixed investment		17.5	5.4	7.6	7.7	7.0	6.9	6.2	6.0	5.5	5.0
Producers' dur. equipment		20.9	-0.5	7.5	7.8	7.5	7.6	6.9	6.6	5.9	5.3
Nonres. structures		8.4	23.8	8.1	7.1	5.8	5.0	4.5	4.6	4.4	4.2
Residential structures		-5.2	-0.3	0.9	1.7	-1.8	-1.6	-1.4	-1.5	-1.2	-0.8
Exports		-0.9	25.1	4.3	6.7	2.1	11.4	4.1	9.6	1.4	11.2
Imports		9.3	3.3	16.0	10.9	8.0	9.2	5.8	9.9	6.6	8.9
Gov't. cons. & investment		-0.6	-0.4	1.2	0.2	1.4	1.4	0.4	-0.2	1.2	-0.8
Federal		-3.5	-4.9	-1.2	-3.7	-0.6	-0.6	-3.0	-4.9	-1.0	-6.5
Defense		-5.5	-7.1	0.0	-5.0	-0.4	-0.3	-2.8	-6.7	-0.9	-5.9
State & local		1.1	2.0	2.7	2.4	2.5	2.6	2.4	2.5	2.3	2.4
Change in bus. inventories	Bill. Ch. $	34.5	17.4	25.6	32.0	36.6	28.9	31.5	32.3	36.7	32.7
Nonfarm		34.6	19.5	26.0	31.7	35.8	27.8	30.0	30.5	34.6	30.6
Net exports		-137.4	-98.2	-125.2	-137.2	-152.5	-151.4	-157.2	-161.6	-176.4	-175.0
Nominal GDP	% change	3.8	5.5	6.4	5.3	4.5	4.4	4.8	4.6	4.6	4.6
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	120.0	120.5	121.3	122.0	122.5	123.0	123.5	123.9	124.3	124.7
Unemployment rate	%	5.3	5.3	5.3	5.1	5.0	5.0	4.9	4.9	4.9	4.9
Industrial prod. index	% change	3.3	4.5	3.5	3.5	3.3	3.2	2.6	2.3	1.7	2.3
Capacity util. rate - mfg.	%	82.3	82.3	82.3	82.3	82.3	82.3	82.3	82.3	82.3	82.3
Housing starts	Millions	1.49	1.42	1.45	1.42	1.39	1.39	1.37	1.35	1.33	1.32
Light motor vehicle sales		15.07	14.82	15.27	14.99	15.01	14.94	14.92	14.91	14.91	14.91
North Amer. produced		13.38	13.07	13.36	13.13	13.16	13.15	13.14	13.14	13.14	13.14
Other		1.69	1.75	1.91	1.86	1.85	1.79	1.78	1.77	1.77	1.77
INCOME AND SAVING											
Nominal GNP	Bill. $	7598.9	7707.6	7824.5	7924.2	8008.0	8091.4	8187.0	8275.3	8365.3	8457.2
Nominal GNP	% change	3.3	5.8	6.2	5.2	4.3	4.2	4.8	4.4	4.4	4.5
Nominal personal income		5.7	5.4	6.2	5.0	4.6	4.9	5.4	4.8	4.7	5.3
Real disposable income		4.8	2.5	5.2	3.0	2.4	2.3	4.1	1.8	1.7	2.3
Personal saving rate	%	5.3	5.1	5.1	5.1	4.9	4.8	5.1	5.0	4.8	4.7
Corp. profits, IVA & CCAdj.	% change	3.3	-1.8	27.2	1.1	-2.5	-4.8	4.2	2.0	2.4	0.1
Profit share of GNP	%	8.7	8.5	8.9	8.8	8.7	8.5	8.5	8.4	8.4	8.3
Excluding FR Banks	%	8.4	8.3	8.7	8.6	8.4	8.2	8.2	8.2	8.1	8.1
Federal surpl./deficit	Bill. $	-120.8	-100.5	-128.3	-118.2	-111.5	-119.1	-134.6	-125.5	-119.5	-117.5
State & local surpl./def.		89.2	90.3	96.0	94.0	91.7	90.0	89.1	88.7	88.0	84.5
Ex. social ins. funds		33.8	36.3	42.3	40.5	38.4	36.9	36.2	36.0	35.5	32.2
PRICES AND COSTS											
GDP implicit deflator	% change	1.7	1.3	2.9	2.4	1.9	1.9	2.4	2.5	2.6	2.6
GDP chn.-wt. price index		2.0	1.8	3.1	2.5	2.2	2.2	2.7	2.8	2.9	2.9
Gross Domestic Purchases chn.-wt. price index		1.9	2.4	2.4	1.9	2.1	2.3	2.7	2.6	2.7	2.7
CPI		2.3	3.1	2.5	2.1	2.6	2.9	2.9	2.9	3.0	3.1
Ex. food and energy		2.4	2.7	2.2	2.7	3.0	3.1	3.2	3.2	3.2	3.3
ECI, hourly compensation[1]		2.5	3.1	3.4	3.3	3.7	3.6	3.7	3.7	3.8	3.8
Nonfarm business sector											
Output per hour		0.0	1.5	0.8	0.8	1.0	1.0	1.0	0.9	0.7	0.7
Compensation per hour		3.3	3.6	3.6	3.4	3.6	3.9	3.7	3.7	3.7	3.7
Unit labor cost		3.3	2.1	2.7	2.6	2.6	2.8	2.7	2.8	3.0	3.0

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	96Q4/ 95Q4	97Q4/ 96Q4	98Q4/ 97Q4
Real GDP	4.3	3.4	2.9	2.5	2.4	2.3	2.1	2.0	2.0	3.2	2.8	2.1
Gross dom. purchases	2.0	5.0	3.5	3.4	2.4	2.6	2.4	2.8	1.9	3.4	3.6	2.4
Final sales	5.3	2.9	2.5	2.3	2.9	2.1	2.1	1.7	2.2	3.2	2.6	2.0
Priv. dom. final purchases	3.1	4.3	3.1	2.9	2.6	2.4	2.4	2.3	2.3	3.1	3.2	2.3
Personal cons. expenditures	2.4	3.3	2.2	2.1	1.8	1.7	1.7	1.7	1.7	1.9	2.4	1.7
Durables	0.4	1.1	0.4	0.5	0.3	0.3	0.3	0.3	0.3	0.5	0.6	0.3
Nondurables	0.4	1.0	0.7	0.7	0.6	0.5	0.5	0.5	0.5	0.4	0.7	0.5
Services	1.6	1.2	1.1	1.0	0.9	0.9	0.9	0.9	0.9	1.0	1.1	0.9
Business fixed investment	0.6	0.8	0.9	0.8	0.8	0.7	0.7	0.7	0.6	1.0	0.8	0.7
Producers' dur. equip.	-0.0	0.6	0.7	0.6	0.7	0.6	0.6	0.5	0.5	0.8	0.6	0.5
Nonres. structures	0.6	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.1
Residential structures	-0.0	0.0	0.1	-0.1	-0.1	-0.1	-0.1	-0.0	-0.0	0.2	-0.0	-0.0
Net exports	2.3	-1.5	-0.7	-0.9	0.1	-0.3	-0.2	-0.8	0.1	-0.2	-0.8	-0.3
Exports	2.7	0.5	0.8	0.3	1.4	0.5	1.2	0.2	1.4	0.9	0.7	0.8
Imports	-0.4	-2.1	-1.5	-1.1	-1.3	-0.8	-1.4	-1.0	-1.3	-1.1	-1.5	-1.2
Government cons. & invest.	-0.1	0.2	0.0	0.2	0.3	0.1	-0.0	0.2	-0.1	0.4	0.2	0.0
Federal	-0.3	-0.1	-0.2	-0.0	-0.0	-0.2	-0.3	-0.1	-0.4	0.1	-0.1	-0.2
Defense	-0.3	0.0	-0.2	-0.0	-0.0	-0.1	-0.3	-0.0	-0.2	0.0	-0.1	-0.2
Nondefense	-0.0	-0.1	-0.0	-0.0	-0.0	-0.1	-0.0	-0.0	-0.2	0.1	-0.0	-0.1
State and local	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Change in bus. inventories	-1.0	0.5	0.4	0.3	-0.4	0.1	0.0	0.2	-0.2	0.0	0.2	0.1
Nonfarm	-0.9	0.4	0.3	0.2	-0.4	0.1	0.0	0.2	-0.2	0.0	0.1	0.0
Farm	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP residual	0.0	0.1	0.0	0.0	-0.0	0.0	0.0	0.0	-0.0	0.0	0.0	0.0

Note. Components may not sum to totals because of rounding.

Strictly Confidential (FR)
Class II FOMC

STAFF PROJECTIONS OF FEDERAL SECTOR ACCOUNTS AND RELATED ITEMS
(Billions of dollars except as noted)

March 19, 1997

	Fiscal year[5]				1996				1997				1998			
Item	1995[a]	1996[a]	1997	1998	Q1[a]	Q2[a]	Q3[a]	Q4[b]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1352	1453	1532	1575	322	446	362	346	344	460	382	365	350	467	393	382
Outlays[1]	1516	1560	1633	1694	393	392	395	405	414	407	407	427	420	424	423	479
Surplus/deficit[1]	-164	-107	-101	-119	-72	54	-33	-59	-70	54	-26	-62	-70	43	-30	-97
On-budget	-226	-174	-178	-194	-84	14	-35	-77	-83	13	-31	-72	-83	-1	-37	-109
Off-budget	62	67	77	75	12	39	2	18	14	40	6	10	13	45	7	12
Surplus excluding deposit insurance[2]	-182	-116	-112	-124	-75	52	-34	-66	-71	52	-27	-63	-71	42	-32	-98
Means of financing																
Borrowing	171	130	104	138	80	-23	39	49	45	-33	42	50	69	-24	43	77
Cash decrease	-2	-6	4	0	-1	-16	-6	11	14	-17	-4	10	10	-15	-5	10
Other[3]	-5	-16	-7	-19	-7	-14	0	-1	10	-4	-12	2	-9	-4	-8	10
Cash operating balance, end of period	38	44	40	40	22	38	44	33	19	36	40	30	20	35	40	30
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1459	1544	1635	1688	1523	1576	1582	1623	1619	1639	1658	1674	1672	1693	1714	1734
Expenditures	1629	1683	1749	1813	1678	1702	1703	1724	1747	1757	1769	1793	1806	1818	1833	1851
Consumption expend.	455	457	461	466	454	464	461	457	462	461	463	465	467	466	467	463
Defense	304	303	303	305	299	307	305	304	303	302	303	304	306	304	304	302
Nondefense	151	155	158	162	155	156	157	153	159	159	160	161	161	162	163	161
Other expenditures	1175	1226	1288	1346	1225	1239	1241	1267	1285	1296	1306	1328	1339	1353	1366	1388
Current account surplus	-171	-139	-115	-125	-155	-127	-121	-100	-128	-118	-112	-119	-135	-125	-119	-117
Gross investment	65	63	62	62	65	66	64	61	62	62	62	62	62	61	61	60
Current and capital account surplus	-236	-202	-176	-186	-220	-193	-185	-162	-191	-180	-174	-181	-197	-187	-181	-178
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-257	-229	-237	-265	-239	-226	-221	-211	-248	-245	-245	-257	-275	-267	-262	-261
Change in HEB, percent of potential GDP	-.1	-.4	.1	.4	.1	-.2	-.1	-.1	.5	0	0	.2	.2	-.1	-.1	0
Fiscal impetus (FI), percent, cal. year	-5.6	-2	-2.5	-3.2	1.3	1.8	-.4	-2.2	.4	-1.6	-.1	-1.4	.1	-1.4	-.4	-2.4

1. OMB's February 1997 deficit estimates (assuming the enactment of the President's proposals) are $126 billion in FY97 and $121 billion in FY98. CBO's March 1997 baseline deficit estimates are $115 billion in FY97 and $122 billion in FY98. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus is excluded from the on-budget deficit and shown separately as off-budget, as classified under current law. The Postal Service deficit is included in off-budget outlays beginning in FY90.

2. OMB's February 1997 deficit estimates (assuming the enactment of the President's proposals), excluding deposit insurance spending, are $138 billion in FY97 and $125 billion in FY98. CBO's March 1997 baseline deficit estimates, excluding deposit insurance, are $128 billion in FY97 and $126 billion in FY98.

3. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.

4. HEB is the NIPA current and capital account surplus in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output generated by 1.8 percent real growth and an associated unemployment rate of 6 percent. Quarterly figures for change in HEB and FI are not at annual rates. Change in HEB, as a percent of nominal potential GDP, is reversed in sign. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (1992) dollars, scaled by real federal consumption plus investment. For change in HEB and FI, negative values indicate restraint.

5. Fiscal year data for the unified budget come from OMB; quarterly data come from the Monthly Treasury Statement and may not sum to OMB fiscal year totals.

a--Actual.
b--Preliminary.

Confidential FR Class II
March 19, 1997

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

			Nonfederal						
				Households					Memo:
Period [1]	Total [2]	Federal government [3]	Total [4]	Total	Home mortgages	Consumer credit	Business	State and local governments	Nominal GDP
Year									
1986	12.1	13.6	11.7	11.4	13.8	9.2	12.2	10.8	5.0
1987	9.2	8.0	9.6	12.2	16.3	5.1	6.7	12.1	7.4
1988	9.0	8.0	9.3	9.6	10.9	8.6	9.7	6.5	7.6
1989	7.6	7.0	7.8	8.7	10.1	6.0	7.5	5.7	6.4
1990	6.6	11.0	5.3	7.9	10.1	2.0	3.1	4.9	4.4
1991	4.5	11.1	2.5	5.2	6.8	-1.7	-1.7	8.2	3.8
1992	4.8	10.9	2.8	5.2	6.1	0.6	0.5	2.0	6.3
1993	5.3	8.3	4.2	6.4	5.5	7.7	1.5	5.7	4.8
1994	5.0	4.7	5.1	8.7	6.7	14.6	3.5	-3.4	5.9
1995	5.5	4.1	5.9	8.2	6.2	14.3	6.0	-3.5	3.8
1996	5.4	4.0	5.9	7.8	8.3	8.3	4.7	1.2	5.0
1997	5.1	2.8	5.9	6.3	6.9	6.0	6.3	2.0	5.2
1998	5.3	4.3	5.6	5.8	6.1	6.0	6.3	2.1	4.7
Quarter									
1995:1	6.4	7.1	6.2	8.3	6.6	13.9	6.7	-4.0	3.8
2	6.5	5.2	7.0	8.2	6.1	15.1	7.4	0.0	3.1
3	4.2	2.4	4.8	8.5	6.8	14.7	4.2	-9.2	6.0
4	4.3	1.6	5.3	6.7	4.8	10.7	5.2	-1.1	2.3
1996:1	6.4	6.6	6.3	9.3	9.9	10.8	4.3	-0.3	4.2
2	5.2	1.7	6.5	8.4	8.4	7.8	4.6	4.1	6.5
3	5.1	4.3	5.3	7.1	7.2	8.3	5.9	-5.7	3.8
4	4.4	3.1	4.9	5.5	6.5	5.5	3.6	6.9	5.5
1997:1	4.7	2.2	5.6	6.2	6.9	5.9	6.0	0.6	6.4
2	5.2	1.6	6.4	6.4	6.8	5.9	6.6	5.8	5.3
3	5.0	4.2	5.3	6.2	6.7	5.9	6.0	-1.7	4.5
4	5.1	3.0	5.8	6.0	6.4	5.9	6.1	3.1	4.4

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 1996:Q4 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2. On a monthly average basis, total debt grows 5.4 percent in 1996, 5.0 percent in 1997, and 5.2 percent in 1998.

3. On a monthly average basis, federal debt rises 3.8 percent in 1996, 2.8 percent in 1997, and 3.8 percent in 1998.

4. On a monthly average basis, nonfederal debt increases 6.0 percent in 1996, 5.7 percent in 1997, and 5.6 percent in 1998.

2.6.3 FOF

Flow of Funds Projections: Highlights
(Billions of dollars except as noted)

Category	Calendar year 1995	Calendar year 1996	Calendar year 1997	Calendar year 1998	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 H1	1998 H2
					Seasonally adjusted annual rates							
Net funds raised by domestic nonfinancial sectors												
1 Total	645.6	663.8	649.8	730.6	586.2	571.0	602.4	682.1	649.1	665.7	715.0	746.1
2 Net equity issuance	-74.2	-82.6	-94.4	-82.6	-138.8	-72.0	-88.0	-82.0	-104.8	-102.8	-77.6	-87.6
3 Net debt issuance	719.8	746.4	744.2	813.1	725.0	643.0	690.4	764.1	753.9	768.5	792.6	833.7
Borrowing sectors												
Nonfinancial business												
4 Financing gap [1]	57.7	14.5	44.8	83.4	29.9	20.5	24.6	39.4	54.7	60.3	75.3	91.5
5 Net equity issuance	-74.2	-82.6	-94.4	-82.6	-138.8	-72.0	-88.0	-82.0	-104.8	-102.8	-77.6	-87.6
6 Credit market borrowing	233.8	193.9	272.6	288.3	249.5	155.5	261.7	288.1	266.0	274.6	281.8	294.7
Households												
7 Net borrowing	381.1	394.3	345.1	336.2	375.7	297.1	338.9	351.0	346.8	343.7	333.7	338.7
8 Home mortgages	197.7	278.7	250.9	237.2	255.8	234.7	252.2	252.2	252.2	247.2	237.2	237.2
9 Consumer credit	141.6	94.4	73.8	77.5	98.0	66.2	72.4	73.3	74.3	75.0	76.5	78.5
10 Debt/DPI (percent) [2]	91.2	93.7	94.9	95.8	94.4	94.7	94.4	94.7	95.1	95.5	95.5	96.1
State and local governments												
11 Net borrowing	-39.6	13.3	21.4	23.5	-61.6	73.9	6.2	63.4	-18.6	34.6	33.0	14.0
12 Current surplus [3]	108.4	116.0	109.5	110.8	113.9	111.2	102.5	96.7	124.7	114.1	111.6	109.9
Federal government												
13 Net borrowing	144.4	145.0	105.1	165.2	161.3	116.5	83.6	61.6	159.7	115.6	144.1	186.3
14 Net borrowing (quarterly, n.s.a.)	144.4	145.0	105.1	165.2	39.3	48.7	45.5	-32.5	42.1	50.1	45.0	120.2
15 Unified deficit (quarterly, n.s.a.)	146.3	110.6	103.9	154.4	33.0	59.3	69.9	-53.6	25.7	62.0	27.0	127.4
16 Funds supplied by depository institutions	274.6	233.4	263.9	264.4	265.2	220.5	239.8	271.4	260.4	284.2	261.2	267.7
Memo (percentage of GDP)												
17 Domestic nonfinancial debt [4]	186.6	188.3	188.1	189.0	188.9	188.6	187.8	187.7	188.0	188.3	188.7	189.3
18 Domestic nonfinancial borrowing	9.9	9.9	9.3	9.7	9.5	8.3	8.8	9.6	9.4	9.5	9.6	9.9
19 Federal government [5]	2.0	1.9	1.3	2.0	2.1	1.5	1.1	0.8	2.0	1.4	1.7	2.2
20 Nonfederal	7.9	7.9	8.0	7.8	7.4	6.8	7.7	8.8	7.4	8.0	7.9	7.7

Note. Data after 1996:Q4 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
3. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
4. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
5. Excludes government-insured mortgage pool securities.

2.6.4 FOF

International Developments

Recent Developments

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies has appreciated 2-1/4 percent further since the February FOMC meeting. Continued signs of stronger-than-expected real output growth in the United States raised the perceived likelihood of tighter U.S. monetary conditions and contributed to upward pressure on the dollar.

Much of the dollar's rise during the intermeeting period has been in terms of the mark and other European currencies. Early in the period, indicators of sluggish economic activity in Germany raised concerns that the German government deficit will not meet the Maastricht standard and contributed to downward pressure on the mark. Subsequently, data showing strong growth in German M3 and increased speculation about the prospects for a delay in EMU boosted the mark. On balance, the dollar has appreciated a little more than 2 percent against the mark and French franc since the February FOMC meeting and considerably more against the lira and the Swedish krona. The dollar has appreciated 1 percent against the yen since the February FOMC meeting. In early February, reports of difficulties at Japanese financial firms contributed to yen depreciation. Since then, data showing stronger economic activity in Japan and a larger-than-expected increase in the January current account surplus have lent support to the yen. The dollar has appreciated 1-1/4 percent, on balance, against the Mexican peso as uncertainty about the final re-certification of Mexico as a drug-fighting ally weighed on the peso.

Both short-term and long-term market interest rates in the major foreign industrial countries rose about 15 basis points, on average, over the intermeeting period. Long-term rates rose more than 50 basis points in Italy in response to concerns about the passage of a mini-budget to lower the budget deficit further and the prospects for Italy's participation in EMU; Spanish rates moved up somewhat less on EMU concerns. Long-term rates fell about 10 basis points in Japan, as passage of the fiscal 1998 budget dashed hopes for less fiscal contraction, and about 20 basis points in Switzerland, as economic activity remained sluggish. Comparable U.S. long-term rates rose more than 25 basis points during the period.

. The Desk did not intervene.

Data for the first quarter suggest that economic activity has continued to expand moderately on average in the foreign G-7 countries; output growth has been strong in Japan, Canada, and the United Kingdom, but was considerably weaker in the continental European countries. In advance of the increase in the consumption tax on April 1, Japanese industrial production rose in January and new car registrations increased on average in January and February. Japanese real GDP grew at a seasonally adjusted annual rate of 3.9 percent in the fourth quarter; consumption spending and private investment expanded briskly, and net exports contributed 1.6 percentage points to total growth. In Canada, orders and shipments (January) and housing starts (January and February) suggest that real output remains strong after expanding at a seasonally adjusted annual rate of 2.9 percent in the fourth quarter. Domestic demand, particularly investment, grew very sharply while net exports made a sizable negative contribution to output growth (in part a consequence of the GM strike). In the United Kingdom, data on retail sales and orders for January and February indicate that activity is continuing to expand briskly; real output grew at a seasonally adjusted annual rate of 3.4 percent in the fourth quarter. In contrast, in Germany industrial production declined in January, and the unemployment rate moved up to 11.3 percent for both January and February (from 10.9 percent in December) following fourth-quarter growth in real GDP of only 0.3 percent, at a seasonally adjusted annual rate. However, unusually cold winter weather accounts for some of this weakness; in January, industrial production excluding construction rose.

The rate of consumer price inflation remains generally subdued in the foreign G-7 countries. In Japan, prices edged up slightly in February. In Italy, the consumer price index was 2.4 percent above its year-earlier level, a rate of increase less than half that recorded twelve months earlier. In contrast, in the United Kingdom, the twelve-month increase in retail prices excluding mortgage interest payments remained above 3 percent in January; the government's target rate is 2-1/2 percent or less.

Economic activity continued to expand rapidly during the fourth quarter in Mexico, Argentina, and Brazil. In Mexico, fourth-quarter real GDP was 7.6 percent higher than in the same quarter a year earlier and, for the first time, exceeded the level achieved before the downturn that followed the December 1994 peso crisis. Mexico's current account deficit widened further in the fourth quarter and brought the deficit for the year to $1.8 billion, somewhat greater than that recorded in 1995.

The nominal U.S. trade deficit on goods and services widened in December as exports declined, particularly in categories of goods that had risen sharply in the previous two months, and imports rose. The average trade deficit on goods and services was significantly smaller in the fourth quarter than it was in the third. Exports of goods and services rose 5 percent in the fourth quarter with all major trade categories except automotive products showing increases; automotive exports were held down by the strike against GM. Imports of goods and services rose only slightly in the fourth quarter as declines in automotive imports from Canada (which were affected by the GM strike to a greater extent than exports) nearly offset increases in a wide range of other categories. The value of imported oil was slightly higher than in the third quarter, as an 8 percent drop in quantity was more than offset by a sharp increase in price. A larger-than-normal stock drawdown and an increase in domestic crude oil production offset higher consumption and led to the lower quantity of oil imports. Department of Energy preliminary statistics for January and February indicate that the volume of oil imports remained at the fourth-quarter rate.

The U.S. current account deficit narrowed significantly in the fourth quarter. The smaller trade deficit on goods and services accounted for most of the improvement, but the deficit on net investment income narrowed as well. For 1996 as a whole, the current account deficit was $165 billion, $17 billion larger than in 1995.

In January, prices of exports rose slightly. Small price increases were recorded in most major trade categories including agricultural products, whose prices had declined in the previous seven months. Prices of non-oil imports, particularly for capital goods, decreased slightly in January.

The average price of imported oil in the fourth quarter was 14 percent above its third-quarter level. The price rose another 1-1/4 percent in January, placing it 38 percent above its December 1995 level. In early 1997, spot oil prices initially fluctuated around end-of-December levels as extremely cold weather in Europe accompanied by the low level of heating oil stocks offset the downward pressure from the onset of oil deliveries from Iraq. Prices began to decline during the last half of January as concerns over heating oil inventories abated. The spot price for WTI plummeted almost $3 per barrel in February as more Iraqi oil appeared on the spot market and consumption declined, reflecting the mild weather in the northeastern United States. Spot WTI is trading in the $20-22 per barrel range, near its end-February price.

Outlook

The staff projects that real output in our foreign trading partners (weighted by bilateral shares in U.S. nonagricultural exports) will grow about 4 percent this year and essentially the same rate next year, a bit stronger than our projection in the January Greenbook. We project that the dollar will remain near its recent elevated levels before drifting down slightly later in the forecast period, resulting in a path for the dollar that is above that contained in the January Greenbook. The higher dollar contributes to increased growth of U.S. imports. With the upward revision to the staff forecast for near-term growth in U.S. GDP also raising imports, real import growth should exceed that for real exports both this year and next. As a consequence, real net exports make a negative contribution to GDP growth of about 3/4 percentage point in 1997 and 1/3 percentage point in 1998, a projection somewhat larger than in the January Greenbook.

Summary of Staff Projections
(Percentage change from end of previous period)

Measure	1996: Q4	1997			1998
		Q1	Q2	H2	
Foreign output	4.7	3.9	4.1	3.9	3.8
Previous	3.7	3.9	3.8	4.0	3.8
Real exports	25.1	4.3	6.7	6.6	6.5
Previous	22.6	1.8	7.3	6.6	7.1
Real imports	3.3	16.0	10.9	8.6	7.8
Previous	5.7	11.6	9.9	8.9	7.2

The Dollar. Over the forecast period, the dollar will be influenced by a number of crosscurrents. We project the dollar will remain around recent high levels in the near term. Uncertainty about the prospects for EMU in Europe could provide some support for the dollar over the forecast period.[1] Later in the forecast period, as the focus of market attention shifts to widening U.S. current account deficits, the dollar will tend to weaken. With Japanese external surpluses again increasing, the decline in the dollar is expected to be largely in terms of the yen. In 1998, the assumed tightening of U.S. monetary policy will limit the downward movement of the dollar. We expect that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will depreciate at a moderate rate throughout the forecast period.

Foreign G-7 countries. Growth of real GDP in the foreign G-7 countries is projected to average 3 percent this year and 2-3/4 percent next year. Upward revisions

1. The current timetable calls for decisions to be made in the spring of 1998 about which EU countries will initially proceed to Stage Three of EMU. However, there is a risk that the start of Stage Three will be delayed beyond January 1, 1999, if key EU countries, particularly Germany and France, fail to achieve satisfactory budget outcomes. Developments that appear to threaten the process of reaching these decisions or to increase the risk that a weak and politically fragmented European System of Central Banks will come into being in 1999 could encourage safe-haven flows of funds into dollar assets.

to 1997 growth for several of the countries reflect the somewhat greater-than-expected strength observed in fourth-quarter data as well as favorable near-term indicators. In Japan, rapid growth in the current quarter and a projected slowdown next quarter are the result of substantial consumer purchases ahead of the increase in the consumption tax followed by a subsequent temporary slump. For 1997 as a whole, net exports should contribute strongly to output growth; domestic demand is expected to firm next year, resulting in a bit higher real output growth. In Germany, real output is expected to be about flat this quarter, owing in part to the effects of severe winter weather. A sharp rebound is projected next quarter in both consumption and investment spending. Over the four quarters of 1997, net exports are projected to contribute nearly 1 percentage point to output growth. In 1998, domestic demand is expected to strengthen while the contribution from net exports lessens, maintaining growth in real output at nearly 2-1/2 percent. In the United Kingdom, real GDP growth is expected to remain healthy over the forecast period, but to slow from 3 percent this year to about 2-1/4 percent next year as domestic demand moderates in response to projected monetary tightening. In Canada, continued rapid growth in investment spending should support vigorous output expansion over the forecast period. With net exports no longer subtracting from output growth, real GDP growth should pick up to nearly 3-1/2 percent this year but moderate next year as export growth slows.

Inflation in the foreign G-7 countries is projected to rise a bit on average this year (weighted by bilateral U.S. non-oil import shares) as lower inflation in several of these countries is offset by the transitory effect on Japanese inflation of the rise in the consumption tax. In 1998, the return to stability in measured prices in Japan should lower average inflation in the foreign G-7 countries to about 1 percent.

In constructing this forecast, we have assumed little change on average from current levels in short-term interest rates abroad this year, as some further declines in Italian short-term rates about offset an assumed increase in rates in Canada and the United Kingdom during the second half of the year. Next year, short-term rates are assumed to move up slightly on average from current levels, reflecting the continuing expansion of economic activity in these countries. Long-term rates are assumed to change little over the forecast period, with higher rates in some countries, particularly Japan, offset by further declines in Italian rates.

Other countries. We project that real GDP in our major developing-country trading partners will increase at a slightly less than 6 percent annual rate in 1997-98, a forecast roughly unchanged from that in the January Greenbook.

Real GDP in our major trading partners in Latin America is expected to expand on average about 4-1/2 percent in 1997. Following its strong rebound last year, Mexican real GDP growth should slow to 4-3/4 percent in 1997 and a bit less next year, narrowing the gap between actual and potential output. We expect 1997 real GDP growth in Argentina and Brazil to be about 4 percent and 3 percent, respectively; in 1998, growth in Argentina should strengthen in response to assumed passage of structural reforms in the labor market. Concerns about possible currency devaluation pose some risks to our forecast for Brazil.

Real output in our major Asian trading partners is expected to expand 6-3/4 percent in 1997, slightly lower than the forecast in the last Greenbook; our forecast for real growth during 1998 remains 7 percent. In the case of South Korea, the 6-3/4 percent growth forecast for 1997 is subject to some downside risk due to possible renewed labor unrest and an unfolding financial scandal.

U.S. real exports and imports. We project that real exports of goods and services will remain strong in the current quarter and will grow at a 4-1/4 percent annual rate, much below the extraordinary 25 percent annual rate recorded in the fourth quarter. Exports are projected to expand about 6 percent over the four quarters of 1997 and a bit faster in 1998. Exports of nonagricultural goods other than computers and semiconductors are projected to expand at an annual rate of about 4 percent this year but then to slow to 2-1/2 percent next year, reflecting the lagged response of these exports to the rise in the exchange value of the dollar since early 1995. Agricultural exports are projected to decline in the first half of this year, following a substantial surge of shipments in the fourth quarter of last year. Exports of these products are then projected to resume expanding in the third quarter, when fall harvests are expected to replenish inventories.

Real imports of goods and services are projected to expand rapidly during the current quarter. Much of the projected 16 percent (annual rate) increase is expected to be from rebounds in oil imports and automotive products. Over the remainder of the forecast period, growth in imports of goods and services slows somewhat, averaging about 9 percent, annual rate, for the final three quarters of this year and about 7-3/4 percent next year. Growth of non-oil imports other than computers and semiconductors ("core" imports) is boosted this year by the near-term strength in U.S. GDP and by the lagged effects of lower import prices. Next year, somewhat slower U.S. output growth and less favorable developments in import prices should slow the growth of core imports from about 9 percent in 1997 to 5 percent in 1998.

We expect the quantity of oil imports to rise this quarter as stocks are rebuilt. Oil imports are projected to increase during the remainder of the forecast period, as consumption expands with the increase in U.S. economic activity, and U.S. production declines.

Oil prices. The projected price of imported oil has been revised down by about $0.90/b in the first and second quarters, reflecting the decline in spot prices. The projected spot price of WTI and the oil import unit value return to $19.50/b and $17.00/b, respectively, by the end of 1997. We have revised down these estimates from our January forecast because of the staff's projection of a higher path for the foreign exchange value of the U.S. dollar.

Selected Trade Prices
(Percentage change from end of previous period except as noted; seasonally adjusted)

Trade category	Projection				
	1996: Q4	1997			1998
		Q1	Q2	H2	
Exports					
Nonagricultural	-0.8	-0.9	-1.4	0.4	1.3
Agricultural	-27.8	-0.1	2.0	2.0	2.0
Imports					
Non-oil	-1.4	-4.9	-0.6	2.2	0.2
Oil (level, dollars per barrel)	22.31	21.28	17.77	17.08	17.00

NOTE. Prices for exports and non-oil imports of goods, including computers and semiconductors, are on a NIPA chain-weighted basis.

The price of imported oil for multiquarter periods is the price for the final quarter of the period.

Prices of non-oil imports and exports. Prices of nonagricultural exports are projected to decline somewhat during the first half of this year and then to rise slowly over the remainder of the forecast period in line with comparable U.S. producer prices. Prices of agricultural exports are expected to be about flat in the current quarter and to rise slowly thereafter. Prices of non-oil imports should drop significantly in the current quarter and be about flat next quarter, reflecting the appreciation of the dollar. With the dollar projected to have about reached its peak and commodity prices exerting some temporary upward pressure, non-oil import prices should resume rising during the second half of this year. In 1998, the effects of some retracing of the increase in commodity prices helps to restrain the increase in import prices.

Nominal trade and current account balances. The nominal trade deficit for goods and services is projected to widen over the forecast period from $105 billion in the fourth quarter of 1996 to about $145 billion in the fourth quarter of 1998. The deficit on net investment income is expected to widen this year and next as well. Accordingly, the current account deficit, which averaged $165 billion in 1996, is projected to rise to about $215 billion in 1998, 2-1/2 percent of GDP.

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OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES
(Percent, Q4 to Q4)

Measure and country	1990	1991	1992	1993	1994	1995	1996	--Projected-- 1997	1998
REAL GDP									
Canada	-1.9	0.0	0.5	3.1	4.9	0.7	2.3	3.4	3.0
France	1.5	1.3	0.1	-0.6	4.2	0.4	2.1	2.8	2.4
Germany (1)	6.8	3.3	1.0	-0.2	3.4	0.8	2.2	2.5	2.3
Italy	0.7	1.9	-0.8	-0.0	2.6	2.3	0.5	1.5	2.1
Japan	5.1	2.5	0.1	0.4	0.8	2.6	3.1	2.2	2.4
United Kingdom	-0.7	-1.5	0.3	2.8	4.2	1.9	2.7	3.0	2.3
Average weighted by 1987-89 GDP	2.8	2.8	0.2	0.7	2.8	1.7	2.3	2.5	2.4
Average weighted by share of U.S. nonagricultural exports									
Total foreign	2.5	2.9	1.9	3.2	5.0	1.7	4.0	4.0	3.8
Foreign G-7	0.7	1.5	0.3	1.8	3.8	1.3	2.4	2.9	2.7
Developing Countries	6.2	6.4	5.1	6.0	7.0	2.1	6.7	5.9	5.9
CONSUMER PRICES									
Canada	4.9	4.1	1.8	1.8	0.0	2.1	2.0	1.5	1.4
France	3.5	3.0	1.8	2.1	1.6	1.9	1.7	1.6	1.8
Germany (1)	3.0	4.0	3.4	4.2	2.6	1.7	1.4	1.6	1.6
Italy	6.4	6.2	4.8	4.2	3.8	5.8	2.7	2.3	2.3
Japan	3.2	3.2	0.9	1.2	0.8	-0.8	0.1	1.4	0.2
United Kingdom (2)	9.2	5.7	3.7	2.7	2.2	2.9	3.2	2.7	3.0
Average weighted by 1987-89 GDP	4.7	4.4	2.4	2.5	1.8	1.7	1.5	1.8	1.4
Average weighted by share of U.S. non-oil imports	4.3	4.1	1.9	2.0	1.0	1.1	1.3	1.6	1.1

1. West German data through 1991, all Germany thereafter.
2. CPI excluding mortgage interest payments which is the targeted inflation rate.

OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES
(Percent, quarterly change at an annual rate)

	1996				Projected 1997				Projected 1998			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP												
Canada	1.4	1.4	3.3	2.9	3.5	3.5	3.4	3.3	3.1	3.1	3.0	3.0
France	5.1	-0.5	3.1	0.6	0.8	4.5	3.1	2.7	2.6	2.4	2.3	2.3
Germany	-0.4	6.1	3.0	0.3	0.1	6.0	2.1	2.0	2.3	2.3	2.3	2.3
Italy	1.8	-1.6	2.4	-0.4	1.0	1.4	1.8	1.8	2.0	2.0	2.2	2.2
Japan	8.4	-1.1	1.3	3.9	3.6	1.4	1.9	2.0	2.2	2.4	2.5	2.4
United Kingdom	2.4	2.2	2.7	3.4	3.1	3.2	3.0	2.8	2.4	2.4	2.3	2.1
Average weighted by 1987-89 GDP	4.1	0.7	2.3	2.1	2.2	3.0	2.4	2.3	2.3	2.4	2.4	2.4
Average weighted by share of U.S. nonagricultural exports												
Total foreign	4.7	1.8	4.7	4.7	3.9	4.1	3.9	3.9	3.9	3.9	3.8	3.7
Foreign G-7	3.0	1.2	2.8	2.7	2.9	3.2	2.9	2.8	2.7	2.7	2.7	2.6
Developing Countries	8.8	1.6	8.1	8.5	5.8	5.9	5.9	5.9	6.0	5.9	5.8	5.8
CONSUMER PRICES (1)												
Canada	1.4	1.4	1.4	2.0	2.2	1.7	1.9	1.5	1.3	1.3	1.4	1.4
France	2.1	2.4	1.8	1.7	1.7	1.4	1.6	1.6	1.7	1.7	1.8	1.8
Germany	1.6	1.5	1.4	1.4	1.8	1.7	1.7	1.6	1.6	1.6	1.6	1.6
Italy	5.0	4.2	3.4	2.7	2.5	2.5	2.3	2.3	2.3	2.3	2.3	2.3
Japan	-0.3	0.1	0.0	0.1	0.0	1.5	1.5	1.4	1.5	0.1	0.2	0.2
United Kingdom (2)	2.9	2.8	2.9	3.2	3.2	3.0	2.8	2.7	2.7	2.8	3.0	3.0
Average weighted by 1987-89 GDP	1.7	1.7	1.5	1.5	1.5	1.9	1.9	1.8	1.8	1.4	1.4	1.4
Average weighted by share of U.S. non-oil imports	1.1	1.2	1.1	1.3	1.3	1.8	1.8	1.6	1.6	1.0	1.1	1.1

1. Percent change from same period a year earlier.
2. CPI excluding mortgage interest payments which is the targeted inflation rate.

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1990	1991	1992	1993	1994	1995	1996	-- Projected -- 1997	-- Projected -- 1998
NIPA REAL EXPORTS and *IMPORTS*									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	0.6	0.4	-0.4	-0.7	-0.4	0.3	-0.2	-0.8	-0.3
Exports of G&S	0.6	0.8	0.4	0.5	1.0	0.8	0.9	0.7	0.8
Imports of G&S	-0.0	-0.4	-0.8	-1.1	-1.4	-0.5	-1.1	-1.5	-1.2
	Percentage change, Q4/Q4								
Exports of G&S	7.2	8.6	4.1	4.8	9.9	7.4	7.5	6.1	6.5
Services	8.9	7.1	-0.9	3.9	4.8	5.1	2.9	2.5	3.1
Agricultural Goods	-7.3	10.1	10.4	-5.4	17.1	-3.1	4.0	-4.9	4.1
Computers	12.3	21.7	25.2	22.7	28.8	49.4	32.5	34.1	32.3
Semiconductors	61.5	41.8	64.8	45.1	68.7	29.7	4.2	23.9	26.3
Other Goods 1/	6.0	7.0	2.3	3.6	7.4	5.3	8.0	4.2	2.4
Imports of G&S	0.5	4.1	7.4	10.5	11.8	4.2	8.3	11.0	7.8
Services	5.8	-2.7	1.5	3.6	0.8	4.1	4.8	5.5	2.9
Oil	-15.8	8.1	12.1	10.1	-0.2	0.9	-1.5	9.1	4.2
Computers	2.9	35.9	45.1	38.8	37.3	43.8	23.8	28.1	25.1
Semiconductors	60.9	55.3	42.0	44.9	47.4	57.1	-13.6	29.9	28.7
Other Goods 2/	-0.3	2.5	5.4	9.5	12.5	-1.2	10.0	9.2	5.2
	Billions of chained 1992 dollars								
Net Goods & Services	-61.9	-22.3	-29.5	-72.0	-105.7	-107.6	-113.6	-141.6	-167.6
Exports of G&S	564.4	599.9	639.4	658.2	712.0	775.4	826.0	891.4	949.0
Imports of G&S	626.3	622.2	668.9	730.3	817.6	883.0	939.5	1033.0	1116.5
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-94.7	-9.5	-62.6	-99.9	-148.4	-148.2	-165.1	-187.2	-215.8
Net Goods & Services (BOP)	-80.3	-29.9	-38.3	-72.0	-104.4	-105.1	-114.2	-126.5	-143.8
Exports of G&S (BOP)	536.8	580.7	617.7	643.0	698.3	786.5	835.6	884.4	939.6
Imports of G&S (BOP)	617.1	610.6	655.9	715.0	802.7	891.6	949.8	1010.9	1083.4
Net Investment Income	20.9	15.8	11.2	9.7	-4.2	-8.0	-8.4	-19.0	-30.3
Direct, Net	55.9	55.6	51.6	55.9	47.4	57.5	64.4	70.4	73.1
Portfolio, Net	-35.0	-39.8	-40.4	-46.2	-51.6	-65.5	-72.9	-89.4	-103.4
Net Transfers	-35.2	4.5	-35.5	-37.6	-39.9	-35.1	-42.5	-41.8	-41.8

1. Merchandise exports excluding agricultural products, computers, and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1993				1994				1995			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
	Percentage point contribution to GDP growth											
Net Goods & Services	-1.1	-0.5	-0.3	0.4	-1.1	0.1	1.2	1.0	-1.1	-0.6	-1.3	2.3
Exports of G&S	-0.2	1.6	1.0	1.7	0.3	0.7	1.2	1.2	0.2	0.7	-0.1	2.7
Imports of G&S	-0.9	-2.1	-1.3	-1.2	-1.4	-0.6	0.0	-0.2	-1.3	-1.3	-1.2	-0.4
	Percentage change from previous period, SAAR											
Exports of G&S	-1.6	15.9	9.7	16.5	2.6	5.9	10.7	10.7	1.8	5.6	-0.9	25.1
Services	0.8	9.7	3.4	5.5	-1.1	4.0	18.7	-0.3	2.7	2.8	-3.8	10.1
Agricultural Goods	-24.4	6.8	43.0	62.9	-0.6	-19.8	16.4	-4.9	9.3	-33.7	8.7	48.4
Computers	24.5	16.6	27.6	48.6	33.0	30.1	79.0	61.0	58.7	21.0	18.3	35.7
Semiconductors	131.4	16.2	45.8	106.7	43.6	19.9	28.8	27.6	-0.0	-20.7	2.6	44.9
Other Goods 1/	-6.6	20.2	6.6	11.0	0.0	7.6	0.7	13.4	-4.1	14.0	-2.7	27.9
Imports of G&S	8.2	18.4	10.7	10.3	11.2	4.5	-0.0	1.6	10.6	9.9	9.3	3.3
Services	1.8	7.5	-1.6	-4.0	21.7	-6.7	5.8	-2.4	13.0	1.3	2.6	2.8
Oil	-8.6	27.2	33.5	-36.2	-2.4	5.3	22.0	-17.2	-22.2	59.9	7.0	-29.4
Computers	45.0	30.9	24.8	49.9	29.6	31.9	64.7	51.8	27.7	23.0	22.2	22.2
Semiconductors	65.3	7.3	43.4	85.8	49.3	61.0	76.4	43.6	4.6	-38.5	-19.0	6.9
Other Goods 2/	7.0	19.9	9.5	14.1	6.9	2.4	-10.8	-2.2	12.2	11.6	11.8	4.5
	Billions of chained 1992 dollars											
Net Goods & Services	-99.3	-107.3	-111.7	-104.3	-122.5	-121.4	-101.6	-84.9	-104.0	-114.7	-137.4	-98.2
Exports of G&S	677.6	703.1	719.6	747.6	752.3	763.2	783.0	803.1	806.7	817.9	816.1	863.2
Imports of G&S	777.0	810.4	831.3	851.9	874.9	884.6	884.5	888.0	910.7	932.6	953.5	961.3
	Billions of dollars											
US CURRENT ACCOUNT BALANCE	-118.8	-144.1	-160.0	-170.6	-156.2	-163.9	-150.8	-121.7	-141.1	-162.4	-191.4	-165.5
Net Goods & Services (BOP)	-90.8	-103.5	-113.8	-109.4	-118.1	-127.3	-97.3	-77.6	-98.5	-115.8	-137.1	-105.4
Exports of G&S (BOP)	662.3	686.1	708.3	736.5	755.9	778.9	796.8	814.5	820.4	835.9	822.8	863.1
Imports of G&S (BOP)	753.1	789.6	822.1	845.9	874.0	906.2	894.2	892.0	918.9	951.7	960.0	968.5
Net Investment Income	4.7	-2.5	-6.4	-12.4	-3.6	-3.4	-17.4	-7.6	1.2	-8.9	-16.4	-9.7
Direct, Net	49.5	46.0	47.4	46.9	57.4	59.9	51.3	61.3	66.3	59.5	58.9	73.0
Portfolio, Net	-44.8	-48.5	-53.7	-59.3	-61.0	-63.3	-68.7	-68.9	-65.1	-68.4	-75.3	-82.7
Net Transfers	-32.7	-38.0	-39.9	-48.9	-34.6	-33.2	-36.0	-36.6	-43.8	-37.7	-37.9	-50.5

1. Merchandise exports excluding agricultural products, computers, and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.

Strictly Confidential (FR)
Class II FOMC

March 19, 1997

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

					Projected							
	1996				1997				1998			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
	Percentage point contribution to GDP growth											
Net Goods & Services	-1.1	-0.6	-1.3	2.3	-1.5	-0.7	-0.9	0.1	-0.3	-0.2	-0.8	0.1
Exports of G&S	0.2	0.7	-0.1	2.7	0.5	0.8	0.3	1.4	0.5	1.2	0.2	1.4
Imports of G&S	-1.3	-1.3	-1.2	-0.4	-2.1	-1.5	-1.1	-1.3	-0.8	-1.4	-1.0	-1.3
	Percentage change from previous period, SAAR											
Exports of G&S	1.8	5.6	-0.9	25.1	4.3	6.7	2.1	11.4	4.1	9.6	1.4	11.2
Services	2.7	2.8	-3.8	10.1	4.2	0.6	1.7	3.3	4.3	3.6	2.6	1.9
Agricultural Goods	9.3	-33.7	8.7	48.4	-33.7	-6.7	19.9	10.5	3.4	3.3	4.9	4.8
Computers	58.7	21.0	18.3	35.7	38.6	33.5	32.3	32.3	32.3	32.3	32.3	32.3
Semiconductors	-0.0	-20.7	2.6	44.9	23.9	23.9	23.9	23.9	26.3	26.3	26.3	26.3
Other Goods 1/	-4.1	14.0	-2.7	27.9	4.4	6.6	-4.9	11.4	-1.8	8.1	-6.8	11.1
Imports of G&S	10.6	9.9	9.3	3.3	16.0	10.9	8.0	9.2	5.8	9.9	6.6	8.9
Services	13.0	1.3	2.6	2.8	9.3	5.8	4.2	2.8	2.6	2.7	3.0	3.3
Oil	-22.2	59.9	7.0	-29.4	22.6	32.9	15.7	-24.9	4.6	40.5	14.7	-30.0
Computers	27.7	23.0	22.2	22.2	33.6	26.3	26.3	26.3	25.1	25.1	25.1	25.1
Semiconductors	4.6	-38.5	-19.0	6.9	33.6	28.7	28.7	28.7	28.7	28.7	28.7	28.7
Other Goods 2/	12.2	11.6	11.8	4.5	14.0	7.5	4.7	10.8	2.5	5.8	2.4	10.2
	Billions of chained 1992 dollars											
Net Goods & Services	-104.0	-114.7	-137.4	-98.2	-125.2	-137.2	-152.5	-151.4	-157.2	-161.6	-176.4	-175.0
Exports of G&S	806.7	817.9	816.1	863.2	872.3	886.6	891.2	915.6	924.8	946.3	949.5	975.1
Imports of G&S	910.7	932.6	953.5	961.3	997.5	1023.8	1043.7	1067.0	1082.0	1108.0	1125.9	1150.1
	Billions of dollars											
US CURRENT ACCOUNT BALANCE	-141.1	-162.4	-191.4	-165.5	-173.3	-174.6	-192.9	-207.9	-201.5	-208.2	-222.7	-230.9
Net Goods & Services (BOP)	-98.5	-115.8	-137.1	-105.4	-120.0	-118.9	-133.1	-133.9	-138.7	-140.3	-151.1	-145.1
Exports of G&S (BOP)	820.4	835.9	822.8	863.1	868.9	879.3	882.6	907.0	916.1	937.8	939.7	965.0
Imports of G&S (BOP)	918.9	951.7	960.0	968.5	988.9	998.2	1015.7	1040.8	1054.8	1078.1	1090.8	1110.1
Net Investment Income	1.2	-8.9	-16.4	-9.7	-14.2	-16.8	-20.8	-24.1	-23.8	-28.9	-32.6	-35.8
Direct, Net	66.3	59.5	58.9	73.0	70.8	70.8	69.9	70.0	73.5	72.0	72.9	74.1
Portfolio, Net	-65.1	-68.4	-75.3	-82.7	-85.0	-87.5	-90.7	-94.1	-97.3	-100.9	-105.5	-109.9
Net Transfers	-43.8	-37.7	-37.9	-50.5	-39.0	-39.0	-39.0	-50.0	-39.0	-39.0	-39.0	-50.0

1. Merchandise exports excluding agricultural products, computers, and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.