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Strictly Confidential (FR) Class II FOMC

Part 1

May 15, 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

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SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee
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Domestic Developments

Overview

The U.S. economy has produced an abundance of good news thus far this year. Growth of real GDP in the first quarter greatly outstripped everyone's expectations. The unemployment rate, catching up with the gains in output since last summer, plunged to about 5 percent in April. And although the tightness of the labor market has resulted in some bidding up of wages in the past year, there are few signs of a general pickup in inflation.

Activity in the opening months of 1997 clearly was boosted to an extent by special factors, including mild weather and a recovery in auto production after the fall strikes. Moreover, a substantial portion of the acceleration of output was attributable to inventory restocking. Under the circumstances, it is not surprising that there are indications of a softening in the early spring, exacerbated by renewed labor skirmishing in the auto industry. Our guess is that real GDP growth this quarter will drop to around 1-3/4 percent.

More important, we are once again projecting that growth will proceed on a generally temperate track in subsequent quarters, owing both to moderation of domestic demand trends and to ongoing drag from net exports, which will continue to be affected for a while by lagged effects of the 1996-97 appreciation of the dollar. We offer this projection, however, with the same caveats that accompanied our previous, incorrect, predictions of imminent moderation. Businesses and households are in an upbeat mood. So, too, are the financial markets. After slumping earlier in the intermeeting period, partly because of the System's 25-basis-point tightening action, the stock and bond markets have rallied of late. There is no shortage of liquidity in the economy, and people have huge reserves of wealth that they can tap for spending. Consequently, although we believe that we have made reasonable assumptions about the spending propensities of consumers and firms, we again underscore the risk that the surge of recent quarters could be generating a self-reinforcing momentum that will require a sizable degree of monetary restraint to rein in. Nonetheless, in framing this baseline forecast, we have assumed that no additional firming of money market conditions will occur until well into 1998.

We continue to believe that a substantial slowing of the expansion is necessary to avoid an upturn in the underlying trend in price inflation. Already, a variety of measures point to a step-up in wage and total compensation increases in the past year or so; although not sharp enough to impress many observers, that acceleration is consistent with what might be expected when the economy is operating only a little beyond full employment. Prices, of course, have been quite well behaved. But there can be little doubt that the appreciation of the dollar has helped to damp domestic inflation. In addition, the reported increases in the CPI have been held down by the series of technical changes to the index.

Looking forward, the recent increase in labor utilization and our belief that the dollar's rise likely has run its course lead us to expect that compensation inflation will edge higher and that rising labor costs will soon begin to be passed along in larger price hikes. With unemployment projected to be under 5 percent, we look for reported core CPI inflation to edge above the 3 percent mark in 1998.

Background Factors in the Forecast

Our March forecast assumed that the federal funds rate would remain at or near 5-1/4 percent until next spring. We are now assuming that it will be held at 5-1/2 percent well into next year but then raised somewhat to avert a decline in real money market rates as inflation rises. In the very near term, the combination of a steady Fed stance and indications of more moderate growth should find favor among bond traders, and we anticipate a further mild rally in fixed-income markets. We might be too conservative on this score, for the predicted environment could be one in which the bond market bulls regain ascendance. Our expectation, however, is that market wariness about increased inflation, related in particular to the pressures in the labor market, will contain such enthusiasm and that, after easing just a little from here, bond yields will begin to firm again in the second half of the year as credit demands grow. Long-term rates are projected to move a bit above the recent range as the System tightens next year.

We previously had anticipated that a meaningful correction of the stock market would not come until 1998, and to this point, that prediction does not appear to have fared too badly. To be sure, share prices fell sharply after the March meeting, partly on the prospect of rising interest rates, but they quickly regained the lost ground on favorable reports of corporate earnings, good news about prices and the economy, and hints that the FOMC was not necessarily committed to a sequence of firming steps. The buoyant bond market that we are postulating over the near term could help carry share values to new highs. In 1998, however, stock prices are still expected to decline appreciably, as corporate profit margins are squeezed by higher costs and as actual and anticipated Fed actions to combat inflation weigh on the market.

In the last Greenbook, we lowered substantially our expectations of what might be contained in a budget agreement. Consequently, we were not greatly surprised by the bargain that recently was struck by the President and the congressional leadership:

The agreement, which still has many details left to be filled in, is heavily backloaded and does nothing to address the more serious budgetary problems that loom after 2002. As we had assumed, the agreement does not provide for any additional reductions in the deficit for fiscal 1997, and only small reductions are planned for fiscal 1998. Thus, we still perceive the stance of discretionary fiscal policy to be only slightly restrictive this year and next. Meanwhile, the strength of the economy and, from all appearances, a rise in the effective tax rate have continued to push up federal receipts at a remarkable clip, tilting near-term prospects toward substantially smaller deficits than we had previously projected. We now expect the 1997 unified budget deficit to be $57 billion, down from a projection of $101 billion in the last Greenbook. On the assumption that whatever factors have been boosting receipts will largely carry over into fiscal 1998, we have lowered the deficit forecast for that period as well--from $119 billion in the previous Greenbook to $77 billion in this one.

The foreign exchange value of the dollar continued upward for much of the intermeeting period, but it has recently dropped back. We are anticipating that it will decline gradually over the remainder of 1997 and in 1998, ending up at the same point as in the last Greenbook. Foreign GDP growth is expected to be close to 4 percent both this year and next; this forecast is essentially the same as that of the last Greenbook. Crude oil prices have behaved about as expected in recent months and are assumed to hold near their recent levels through the end of 1998; West Texas intermediate stays at about $19.50 per barrel over this period.

The Current Quarter

Although the international trade report for March still is outstanding and many other first-quarter source data are subject to revision, the information in hand suggests that BEA's initial estimate could be revised up to about 6 percent because of faster inventory accumulation than the BEA had assumed. Nonfarm stocks appear to have risen at an annual rate of more than 5 percent in the first quarter; this rate of growth was significantly faster than that of the previous period, and the step-up is estimated to have contributed about 2-1/4 percentage points to the annual rate of GDP growth last quarter.

That very high rate of stockbuilding was a key consideration in our decision to push the forecast for real GDP growth in the second quarter down to 1-3/4 percent. While inventories appear to have been lean overall at the end of the first quarter and business sales expectations reportedly are quite positive, we do not see concerns about access to supplies giving an extra boost to desired stocks, as happened in 1994.

Consequently, we are predicting a slowing of growth in nonfarm inventory accumulation to 3-1/2 percent at an annual rate in the current quarter; this pace largely reflects desired restocking, although a little unanticipated building may occur at firms whose sales fall short of more buoyant expectations. The slowing of inventory growth from the first-quarter pace subtracts about 3/4 percentage point from growth of real GDP this quarter.

Final sales also are expected to decelerate in the current quarter. Growth of domestic final sales, while still relatively brisk, is likely to fall well short of the unusually rapid pace of the first quarter, and a significant portion of this growth in demand will probably continue to be channeled to foreign producers through strong advances in U.S. imports. We project that the additional deterioration of net exports, much of which is a response to past dollar appreciation, will subtract more than 1/2 percentage point from GDP growth in the second quarter; this drag is more than the external sector exerted on average over the past year.

We are predicting that real personal consumption expenditures will move up at an annual rate of about 2-1/4 percent this quarter. Spending got off to a weak start in April, with a downturn in purchases of light motor vehicles and sluggish sales at non-auto retail stores. This lackluster performance appears to have left the April level of goods expenditures a shade below the average for the first three months of the year in

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

Measure	1997:Q1			1997:Q2	
	Mar. GB	BEA adv.	May GB	Mar. GB	May GB
Real GDP	**3.4**	**5.6**	**6.0**	**2.9**	**1.8**
Private domestic final purchases	5.2	7.1	6.7	3.8	3.5
Personal consumption expenditures	5.0	6.4	5.8	3.2	2.2
Residential investment	.9	5.5	6.4	1.7	1.3
Business fixed investment	7.6	11.9	12.2	7.7	12.2
	Change, in billions of chained (1992) dollars				
Inventory investment	8.2	29.0	35.2	6.3	-13.3
Government outlays for consumption and investment	3.8	-1.8	-.4	.6	6.3
Net exports	-27.1	-31.9	-30.1	-11.9	-12.5

real terms, and appreciable improvement in sales in May and June will be needed to yield the moderate second-quarter gain that we have projected. However, as noted in the overview, the fundamentals of income, wealth, and confidence are very positive.

Good weather this winter probably enabled homebuilders to push construction ahead faster, and we therefore have assumed that some of the first-quarter gain in residential investment was, in effect, "borrowed" from the second quarter. Still, the demand for housing appears to be holding up well, with the restraint from the rise in mortgage rates since last fall being largely offset by the effects of ongoing increases in employment and income. Consequently, we project only a moderate drop-off in starts this quarter and, given normal lags, a further small rise in actual construction expenditures.

Business fixed investment retains considerable vigor, as best we can tell from sorting through the anecdotal reports and the volatile monthly statistical indicators. In the first quarter, the monthly bounces for computers and other high-tech equipment translated into strong gains on a quarterly average basis, but the real news was perhaps the reemergence of strength in orders for other types of machinery and equipment. Although some of the shipments that those orders foreshadow will go to foreign firms, we are projecting solid increases in domestic spending on equipment across a broad range of categories, with outlays for aircraft likely to be particularly strong. The one notable area of near-term softness that we foresee is a downturn in business purchases of autos; they had surged in the first quarter. Contracts for nonresidential building projects have slipped recently, but surveys of market conditions and other reports suggest that the uptrend in construction remains intact.

As usual, our prediction of current-quarter output is importantly influenced by our interpretation of the data from the labor market. In the present case, we have something of a mixed bag. The 140,000 per month increases in payroll employment in March and April were below the recent trend, dragged down in part by the unwinding of the previous weather-induced runup in construction jobs. Still, these gains are far from paltry, and initial claims for jobless benefits have remained low enough to suggest that employment growth remained hefty through the May survey week. On the other hand, the workweek dropped back in April from the extraordinarily high February-March level, so that we probably are on track for only a relatively modest increase in aggregate hours of production workers this quarter. We are inclined to think that the sharp drop in the unemployment rate in April was mainly a catch-up to the outsized GDP gains of the past two quarters (the rate having changed little during that surge in growth).

The rate of rise in the CPI in the second quarter is now projected to be only about 1-1/4 percent at an annual rate. The second-quarter drop in consumer energy prices is expected to be much larger than we had projected in the last Greenbook. In addition, our forecast for consumer food prices has also been revised down significantly; bad weather in Florida and California early this year ended up causing barely a ripple in the food price data for late winter and early spring. We project that the rate of rise in the core CPI will be boosted to an annual rate of almost 3 percent in the second quarter by a moderate step-up in the prices of non-energy services; we are anticipating that increases in the prices of goods will drop back again in coming months after a blip in April.

The Longer-Run Outlook

We expect real GDP to expand at an average annual rate of close to 2-1/2 percent in the second half of 1997 and 2 percent in 1998. Growth of household and business expenditures is projected to slow over time, given already high rates of real asset accumulation and the eventual emergence of less favorable financial factors. The dynamics of the deceleration of activity are due in large part to the expected gearing down of inventory investment from the unsustainable pace of the first quarter and to the persistence of appreciable drag from the external sector. The unemployment rate may well tick up in the near term from the low reading for April, but we think it likely that the rate will drop back below 5 percent after midyear and generally remain there through the end of 1998. This degree of tightness in the labor market is expected to be accompanied by a moderate step-up in compensation increases between now and the end of next year, giving impetus to an acceleration of prices.

Consumer spending. After rising at an annual rate of 4 percent in the first half of 1997, real PCE is projected to increase at a rate of just over 3 percent in the second half of this year. Spending growth is predicted to slow further in 1998 to 2-1/2 percent. Consumer outlays for electronic equipment are expected to continue rising at an impressive clip but less rapidly over time. Moreover, purchases of motor vehicles likely are topping out, and the anticipated softening in the housing sector will damp demand for household goods. Moderation of income growth in coming quarters brings about a slowing of consumer purchases more generally.

Our forecast of growth in real disposable personal income for 1997 has in fact been knocked down a bit in this Greenbook. The trimming of DPI growth in the face of stronger growth of real GDP was prompted by the surprising strength in nonwithheld tax receipts, which led us to raise the ongoing level of taxes from that shown in the last forecast. Given the lack of detail in the available data, we can only conjecture about what lies behind the bulge in nonwithheld tax payments. But none of the most likely explanations, such as an understatement of aggregate NIPA income, a shift in the distribution of taxable income to high-bracket households, or a jump in capital gains realizations, seem to point to a big hit to spending. Thus, we have felt reasonably comfortable letting the higher tax payments come mostly out of personal saving.

Our forecast has spending moving up a touch faster than DPI over the 1997-98 period. The two key elements in that story are the effects of the further rise in the wealth-to-income ratio this year and the lagged response of consumer spending to the strength of income in recent quarters. The trends in consumer loan delinquencies and

Summary of Staff Projections
(Percent change, compound annual rate)

Measure	1997:H1	1997:H2	1998
Real GDP	**3.9**	**2.4**	**2.0**
Previous	3.1	2.5	2.1
Final sales	3.2	2.8	2.0
Previous	2.7	2.6	2.0
PCE	4.0	3.1	2.6
Previous	4.1	2.9	2.5
Residential investment	3.8	-1.8	-1.9
Previous	1.3	-1.7	-1.2
BFI	12.2	8.2	5.6
Previous	7.6	7.0	5.7
Government purchases	.9	1.3	.1
Previous	.7	1.4	.2
	Change, in billions of chained (1992) dollars		
Inventory change	21.9	-13.6	-1.0
Previous	14.6	-3.1	3.8
Net exports	-42.6	-11.5	-23.4
Previous	-39.0	-14.3	-23.6

personal bankruptcies continue to signal a certain amount of financial stress, but the households that are seriously afflicted account for only a small proportion of total income and expenditures, and lenders are expected to continue fine-tuning their provision of credit rather than making sweeping cuts in consumer credit availability.

Residential investment. We are projecting that residential investment expenditures will follow a path of mild contraction from mid-1997 to the end of 1998, declining at an annual rate of roughly 2 percent over that period.

As noted above, we have not yet detected much response among households to the upswing in interest rates since last fall. The relatively modest increase in short-term rates--and thus in rates on many ARMs--has been one factor. But, in fact, borrowers have not shifted away from fixed-rate loans, evidently because they view 30-year FRMs around 8 percent as attractive, especially in locales where house prices have been rising appreciably. Strong employment growth and the surge in income have permitted more families to qualify for fixed-rate loans and have made them more confident about taking on the financial commitment.

After midyear, income growth slows, and conditions in mortgage markets eventually turn less favorable. Consequently, starts of single-family units are projected to decline moderately over the next several quarters. We also anticipate moderate decreases in multifamily starts, not only because of the rise in interest rates and the slowing of the economy but also because of the persistence of high vacancy rates that are damping the opportunities for builders to profit from new construction.

Business fixed investment. Virtually all signs point to ongoing strength in business fixed investment. The burst of sales over the past half-year has spurred expansion plans, and falling prices for high-tech products continue to exert a favorable influence on the cost of capital. Although the cost of external finance has been boosted somewhat by the rise in long-term interest rates since late last year, continued strength in profits and overall cash flow is enabling many firms to spend heavily on new capital without tapping external sources. As the economy slows later this year and in 1998, this set of influences will likely become somewhat less conducive to growth of investment. Nonetheless, gains in real BFI are expected to continue outpacing overall growth of the economy by a substantial margin: We are projecting that a rise of 10 percent this year will be followed by an increase of about 5-1/2 percent in 1998.

Our forecast of equipment spending exhibits a trend of gradual deceleration over the next several quarters. Growth of computer outlays, which has slowed to rates of 25 percent to 30 percent in the past couple of quarters, is projected to proceed at a fairly similar rate, on average, through the remainder of this year and then to taper somewhat further in 1998. Moderation in the pace of economic growth should have some effect on these outlays, especially with many businesses having invested heavily in new hardware over the past two or three years. Still, computers will remain by far the fastest growing major component of real BFI. We expect spending for communications equipment to continue trending up briskly in response to regulatory changes and the pressures to add capacity to accommodate the growth of networking. Outside the high-tech categories, increases in 1997 are expected to be larger than those of 1996; however, investment next year will be limited by the deceleration of output, a flattening of profits, and higher interest rates.

Investment in business structures seems to have gained considerable momentum, and we are looking for a string of fairly large gains over the next few quarters. Construction of new office buildings probably will be especially strong. With vacancy rates falling, owners of existing office buildings in many locales have been able to boost rents substantially over the past year, and the prospect of profitable investment in new structures has brought a strong response from builders and lenders. Hotel construction also should be spurred by a scarcity of rooms in some major cities. As has happened before, overbuilding may well ensue before the current upswing is finished. Nonetheless, a boom mentality akin to that of the 1980s does not appear to have reemerged yet among developers or financiers, and we do not see much risk of a bust in the next couple of years.

Inventory investment. Our expectation is that, by the end of the current quarter, firms generally will have refilled their production pipelines and restocked their shelves. Consequently, inventories in the nonfarm business sector are projected to grow at an annual rate of about 3 percent in the second half of 1997, and a rise of 2-1/2 percent is projected for 1998. The ratio of stocks to sales is expected to change little over the forecast period from the low range into which it fell in the latter part of 1996 and early 1997.

The inventory forecast for the second half of this year makes allowance for some further small increases in the stocks of motor vehicles, as production ticks up from a second-quarter level that has been depressed a bit by strikes. Still more strike-related disruptions to production could well occur in coming months, but we decided not to factor those strikes into our baseline forecast as their effects on auto production and real GDP would most likely be only transitory.

Farm inventories have remained relatively low despite last year's favorable harvests, as demand from domestic and foreign buyers has been strong. We continue to project moderate rebuilding of crop inventories this year and next as a result of further increases in production. Acreage is increasing moderately in 1997, and the planting of spring crops has gotten off to a fast start in most parts of the country. In contrast to the outlook for crop inventories, livestock inventories are expected to fall further as the long-run inventory cycle in the cattle business continues to unfold.

Government spending. Our 1997 forecast of real federal expenditures on consumption and gross investment has been nudged up a bit since the last Greenbook, a reflection of stronger-than-expected outlays over the near term. We now anticipate that these outlays will decline about 1 percent over the four quarters of 1997. The 1998 drop is projected to be close to 4 percent. The declines in defense purchases this year and next are not expected to be quite as large as those of many other recent years, but declines in the nondefense area likely will be fairly sizable by past standards.

Real purchases by state and local governments are projected to rise about 2-1/2 percent in 1997 and 1998, similar to the average gains of the past few years. Although much larger gains have been sustained in some past expansions, we think that political pressure for tax cuts will prevent outlays from accelerating much in this one. A number of states reportedly are considering paring taxes in response to their strengthening financial positions, and some are said to be keeping a lid on spending out of concern that cutbacks in federal grants will impose future pressures on states' financial resources.

Net exports. Even though we project real exports of goods and services to rise fairly briskly from mid-1997 through the end of 1998, imports likely will continue to move up even faster. On net, the changes in exports and imports from mid-1997 forward result in real GDP growth that is about 0.3 percentage point less than the growth of gross domestic purchases. (A fuller discussion of the prospects for the external sector is contained in the *International Developments* section.)

Labor markets. The labor force participation rate has bounced around in recent months, but, on average, it has maintained the marked uptrend of the past year. This rise has again put it a shade above the path that we had anticipated, and we have responded by raising our projection somewhat further. The rate, which barely rounded up to 67.2 percent last month, is projected to edge upward to 67.4 percent in the latter part of 1998. We have continued to slice and dice the data in an effort to understand the recent upswing. More work needs to be done, but at this point we have concluded that the rise should be viewed as primarily a normal cyclical phenomenon, around a longer-run trend line that is essentially flat. Earlier in the economic expansion, a perceived lack of job opportunities, and perhaps some discouragement among middle-aged males displaced by corporate restructuring, resulted in a sag in the participation rate; in the past year, more people have entered the market as job opportunities were seen to be improving. Looking at the composition of the growth in the labor force, we do not think that much of the recent rise has been caused by welfare reform, and because the reforms will still be in their early stages by the end of 1998, we anticipate only a small boost to participation from this source over the next year and a half.

Measured productivity growth got off to a strong start this year, with output per hour in the nonfarm business sector probably up at an annual rate of around 2-1/2 percent in the first quarter. The renewed signs of life in productivity in the past two quarters are encouraging, but a pickup is to be expected in a period of accelerating output, and the gains came after a span of remarkably poor performance. Under the circumstances, we hesitate to revise our assessment of the underlying trend of output per hour despite anecdotes to the effect that businesses have entered a new phase of efficiency improvement. We have raised our forecast of productivity growth for 1997 as a whole to 1-1/4 percent, but we are projecting a dropback to slightly under 1 percent in 1998, in part reflecting the notion that employers are having to hire (and train) less-qualified workers in a period of unusually low unemployment.

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	.9	1.2	.9
Previous	-.1	1.0	.9	.8
Nonfarm payroll	2.0	2.2	1.9	1.3
Previous	2.0	2.2	2.1	1.4
Household employment survey	.6	2.1	2.2	1.2
Previous	.6	2.1	1.9	1.3
Labor force participation rate[1]	66.5	66.9	67.3	67.4
Previous	66.5	66.9	67.1	67.2
Civilian unemployment rate	5.6	5.3	4.8	4.8
Previous	5.6	5.3	5.0	4.9

1. Percent, average for the fourth quarter.

Given our projection of output growth, the productivity forecast implies that firms will need to boost labor input 2-1/2 percent in 1997 and about 1-1/4 percent in 1998. Because we have allowed for a slight lengthening of the average workweek in 1997, payroll employment grows roughly 2 percent, somewhat less rapidly than aggregate hours. Next year, the workweek is flat, and payrolls expand 1-1/4 percent.

Wages and prices. Our basic story with respect to inflation is a simple one: The economy has overshot full employment, and we are witnessing a gradual drift toward higher inflation--that tendency having been muted to date by the appreciation of the dollar and by certain structural shocks, perhaps most notably the changing character of the medical care market. However, the data in hand do not provide definitive support for this story, and we have once again reexamined the aptness of our analysis.

The difficulty in getting a clear signal from the data is illustrated by the latest information on labor compensation. The Employment Cost Index for the first quarter showed a seasonally adjusted increase in hourly compensation of just 2.5 percent at an annual rate, the smallest rise since the same period a year earlier. However, given the quarterly noise in the series, it is wise to focus on the year-on-year comparisons. On this basis, the change in the index for the period ended in March was 3.0 percent, right in line with our previous projection and up 0.4 percentage point from its low at the end of 1995.[1] At the risk of putting too fine a point on a change that, statistically, is only marginally significant, we would note that this degree of pickup in compensation is about what would have been expected from a Phillips curve model embodying a NAIRU in the range of 5-1/2 to 5-3/4 percent.

Looking ahead, we are projecting a further small step-up in compensation inflation this year, bringing the ECI increase for 1997 to nearly 3-1/2 percent. Several factors support this prediction of further acceleration. One is the lagged effect of the larger increase in the CPI in 1996, which will be feeding through to wages via formal or informal cost-of-living adjustments. Another is the second increase in the minimum wage. A third is our prediction of a jobless rate below 5 percent, which suggests that the upward pressures on real compensation should be more intense this year than last.

In this analysis, we are not turning a blind eye to the possibility that compensation practices have changed in ways that bring greater flexibility to company

1. The fact that the first-quarter compensation increase fell short of our prediction while the twelve-month change did not is explained by a revision of seasonal factors in the latest ECI release.

wage structures. However, even if there is more targeting of pay increases to workers with scarce skills, greater use of bonuses as opposed to base-pay increases, and so on, these changes probably only buy companies some limited breathing room: When workers are in short supply, employers will eventually have to pay more, one way or another, for labor input.[2] Although the changes in pay practices may alter the timing or magnitude of responses of compensation to changes in labor market slack, they are not likely to negate that relationship entirely.

A similar observation can be made about the effects of worker insecurity: A shift to a greater degree of insecurity would be expected to lead to a lowering of the NAIRU, but that reduction does not nullify the usual inverse relationship between unemployment and pay increases. On that point, a distinct risk in the forecast is that, with availability of jobs perceived to be increasing, worker insecurity could wane, reinforcing wage pressures. We have not made any special allowance for such a development.

If compensation is accelerating, then prices, too, eventually will accelerate unless productivity trends improve; the squeezing of markups will provide only a temporary stopgap. Business people often say that, in today's competitive world, they have no scope for raising prices and that any increments to wages will have to be offset through gains in efficiency. But we question whether businesses can call forth productivity advances in just the right measure to offset acceleration of hourly compensation. Among other things, the notion that firms have a reserve of cost-reduction opportunities to tap does not seem to square with the image of companies being quick to seize on every opportunity to maximize profits.

Of course, price dynamics might have changed, given the greater exposure of firms to international or domestic competition and the anchor of a more credible anti-inflation monetary policy. In the end, however, there is ample evidence that firms still do raise prices when product markets are tight; and the passthrough of the rising costs of labor or other inputs into prices is more likely when those pressures are widespread, so that firms need not fear losing competitive position. Such conditions prevail in the forecast: Not only are we anticipating that widespread acceleration of compensation rates will be squeezing profit margins, but the pricing "leverage" of firms is enhanced by an upturn in non-oil import prices as the dollar recedes. The

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2. Not all of the cost increases associated with tight labor markets will necessarily show up in the standard measures of compensation. For example, firms that hire workers with fewer skills may be able to hold down wages, but their outlays for training costs will go up. The greater use of stock options in recent years is another example of compensation that does not show up in the standard measures.

thrust of prices would be more substantial were it not for our expectation that expansion of factory capacity, while slowing next year, will be fast enough to hold utilization rates just above their historical averages.

All told, we continue to see gradual acceleration of core inflation as the most likely outcome for the next year and a half. The CPI excluding food and energy is projected to rise 2-3/4 percent in 1997, a little more than in 1996. Next year brings an additional moderate pickup in this inflation measure; we are predicting that the increase will be a little more than 3 percent on an official basis and 3-1/2 percent if adjustment is made for the technical changes to the CPI since 1994.

We have not made any allowance for big shocks to the economy from the food or energy sectors. After some further decline in the near term, retail energy prices are expected to rise gradually and end 1997 at a somewhat lower level than in the fourth quarter of 1996; in the last Greenbook, we had anticipated a net price change of zero over the year. Next year, stable oil prices and a small increase in the combined

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

Measure	1995	1996	1997	1998
Consumer price index	2.6	3.2	2.4	2.9
Previous	2.6	3.2	2.5	3.0
Food	2.6	4.2	2.1	2.7
Previous	2.6	4.2	2.3	2.9
Energy	-1.7	7.6	-1.3	1.3
Previous	-1.7	7.6	.0	.9
Excluding food and energy	3.0	2.6	2.7	3.1
Previous	3.0	2.6	2.8	3.2
ECI for compensation of private industry workers[1]	2.6	3.1	3.4	3.6
Previous	2.6	3.1	3.5	3.7
Prices of non-oil merchandise imports	.8	-2.9	-.0	.6
Previous	.8	-2.8	-.3	.2
	Percentage points			
MEMO				
Adjustment to the core CPI for technical changes	.1	.2	.3	.4
Previous	.1	.2	.3	.4

1. December to December.

margins of refiners and marketers lead to an uptick in the CPI for gasoline. Small iincreases are also projected in the indexes for natural gas and electricity.[3]

Food prices are projected to rise 2.1 percent in 1997, somewhat less than was predicted in the last Greenbook. On net, these prices edged down a bit at retail over the first four months of 1997, but moderate increases are anticipated over the balance of the year. The forecast for 1998 has food price increases picking up from the 1997 pace, roughly in step with the pickup of inflation in general. We still expect to see relatively sharp increases in beef prices in 1998, and even though the world seems to have become more skilled over time at getting by with lean inventories of grains and oilseeds, the present tightness of these stocks causes us some worry about potential risks in the food price outlook if production falls short of current expectations.

We are projecting that the overall CPI will rise 2.4 percent over the four quarters of 1997 after moving up 3.2 percent during 1996 when developments in food and energy markets were adverse. Next year, the CPI increase is predicted to be back up close to the 3 percent mark. As noted in previous Greenbooks--and in the accompanying table--technical adjustments to the CPI are estimated to cancel out a bit of the acceleration that we would otherwise have written down.

Monetary and Credit Flows

We are inclined to attribute the recent rapid growth of the monetary aggregates to the unusually and unexpectedly large federal tax payments associated with the April filing deadline. Households probably built up their money balances to meet these liabilities and, when those payments clear, will not see fit to replenish them. Over the year as a whole, growth of M2 is expected to be somewhat below that of nominal GDP, owing to a rise in the opportunity cost of holding M2 resulting from the policy action taken at the March meeting. Growth of M2 in 1998 remains slightly below the growth of nominal GDP. Brisk growth of M3 is projected this year and next based on a further solid expansion of bank credit and continued strong growth of money funds.

The surprising surge in tax receipts has enabled the Treasury to pay off debt this quarter and is expected to pull down the growth of federal debt to only

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3. We have pulled down the 1998 forecast for electricity by a percentage point in reaction to the recent announcement that the California electricity market will be opened to greater competition starting January 1 of next year, although the degree to which that development will lower prices--or be followed by similar moves in other states--is not fully clear. Given the weight of electricity in the CPI--about 2-1/4 percent--this change to our forecast has only a small effect on the top line.

1-1/4 percent this year. In 1998, with the deficit expected to increase modestly, growth of federal debt picks up to 3 percent.

Our assessment is that financial conditions will remain quite supportive to business borrowing, with only a moderate widening of the narrow spreads now prevailing in the securities markets and on bank loans. Firms are likely to be tapping those sources in greater volume over the remainder of this year and next, in response to the flattening of profits and a rapid expansion of fixed capital and inventories. Those borrowing requirements will continue to be augmented by fundraising to support the ongoing merger wave. Share retirements resulting from mergers and from share repurchase programs are expected to remain well above the amount of new equity issued by nonfinancial corporations.

Growth in household debt is projected to edge lower in 1997 and 1998 but to remain at a pace above that of nominal income. Debt-service burdens creep up a bit further over the forecast period, making it likely that delinquency rates will remain elevated and thereby further restrain banks' willingness to provide credit. The assumed ratcheting up of credit restraint, however, is only modest, and funds for consumer outlays should be available on good terms to all but the weakest borrowers. The growth of durable goods purchases is expected to flag, lessening somewhat the demand for credit. Mortgage credit should remain plentiful, but the upturn in home mortgage rates starting later this year is anticipated to put a dent in housing activity in 1998. As a result, the growth of mortgage debt is expected to soften over the forecast period.

In the state and local government sector, debt growth should remain quite modest in 1997 and 1998. The prevailing political consensus favoring fiscal restraint should keep the capital spending of these jurisdictions on a slow growth track, and with long-term interest rates drifting up, the opportunities to pre-refund debt will be few and far between.

All told, the debt of the nonfinancial sector is anticipated to grow a little more than 4-1/2 percent in 1997, placing it in the middle portion of its annual range but below the expansion of nominal GDP. Debt in 1998 is projected to expand about 5 percent, somewhat faster than nominal GDP.

Alternative Simulations

The alternative simulations this month are based on different paths for the federal funds rate. In the first simulation, the rate is held at its current level through the end of 1998. Because this assumption about the federal funds rate differs from the baseline assumption only for the latter half of 1998--and then only mildly--effects on the economy within the forecast period are negligible. Real GDP in 1998 rises just a tenth more than in the baseline forecast, and the effects on unemployment and inflation are imperceptible. Nonetheless, we have reason for showing this simulation: Although our baseline forecast has real GDP growth moderating in 1998, we do not believe that maintenance of a stable nominal funds rate in the face of an upcreep in inflation is likely to create a path for the real rate that is consistent with further output deceleration in 1999. Consequently, the forces necessary to ultimately turn inflation back down would not emerge.

The second alternative involves a more aggressive approach for capping inflation--preemptive, as it were. The fed funds rate is raised 100 basis points further in a series of steps over the remainder of 1997 and then held steady in 1998. Growth of real GDP in 1998 is appreciably smaller in this alternative, the unemployment rate ends up almost half a percentage point higher than it is in the baseline forecast, and acceleration of inflation is forestalled. Given the high real rate prevailing at the end of the period, the disinflationary trends emerging in 1999 might call for some easing of the funds rate during that year to avoid greater restraint on aggregate demand than would be needed to restore a clear downtilt to the inflation rate.

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

Measure	1996	1997	1998
Real GDP			
Baseline	3.1	3.1	2.0
No further change	3.1	3.1	2.1
Tighter policy	3.1	2.9	1.2
Civilian unemployment rate[1]			
Baseline	5.3	4.8	4.8
No further change	5.3	4.8	4.8
Tighter policy	5.3	4.9	5.2
CPI			
Baseline	3.2	2.4	2.9
No further change	3.2	2.4	2.9
Tighter policy	3.2	2.4	2.5

1. Average for the fourth quarter.

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Class II FOMC

May 15, 1997

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

Interval		Nominal GDP 03/19/97	Nominal GDP 05/15/97	Real GDP 03/19/97	Real GDP 05/15/97	GDP chain-weighted price index 03/19/97	GDP chain-weighted price index 05/15/97	Consumer price index[1] 03/19/97	Consumer price index[1] 05/15/97	Unemployment rate[2] 03/19/97	Unemployment rate[2] 05/15/97
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	4.4	2.5	2.4	2.1	2.1	2.9	2.9	5.4	5.4
1997		5.4	5.5	3.2	3.5	2.4	2.3	2.7	2.5	5.1	5.0
1998		4.6	4.4	2.3	2.1	2.6	2.5	2.8	2.8	4.9	4.8
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	2.6	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	3.4	5.4	5.4
	Q3	3.8	3.8	2.1	2.1	2.0	2.0	2.3	2.8	5.3	5.3
	Q4	5.5	5.3	4.3	3.8	1.8	1.9	3.1	3.3	5.3	5.3
1997	Q1	6.4	8.1	3.4	6.0	3.1	2.8	2.5	2.3	5.3	5.3
	Q2	5.3	3.9	2.9	1.8	2.5	2.1	2.1	1.2	5.1	5.0
	Q3	4.5	4.6	2.5	2.5	2.2	2.3	2.6	2.7	5.0	4.9
	Q4	4.4	4.5	2.4	2.3	2.2	2.4	2.9	3.1	5.0	4.8
1998	Q1	4.8	4.5	2.3	2.1	2.7	2.6	2.9	2.8	4.9	4.8
	Q2	4.6	4.4	2.1	2.0	2.8	2.7	2.9	2.9	4.9	4.8
	Q3	4.6	4.3	2.0	1.9	2.9	2.7	3.0	3.0	4.9	4.8
	Q4	4.6	4.3	2.0	1.9	2.9	2.7	3.1	3.0	4.9	4.8
TWO-QUARTER[3]											
1995	Q2	3.5	3.5	0.6	0.6	2.9	2.9	3.0	3.0	0.0	0.0
	Q4	4.1	4.1	2.0	2.0	2.1	2.1	2.3	2.3	0.0	0.0
1996	Q2	5.4	5.4	3.3	3.3	2.2	2.2	3.4	3.4	-0.2	-0.2
	Q4	4.6	4.6	3.2	3.0	1.9	2.0	3.0	3.0	-0.1	-0.1
1997	Q2	5.9	6.0	3.1	3.9	2.8	2.5	2.3	1.8	-0.2	-0.3
	Q4	4.4	4.6	2.5	2.4	2.2	2.4	2.7	2.9	-0.1	-0.2
1998	Q2	4.7	4.4	2.2	2.1	2.8	2.7	2.9	2.9	-0.1	-0.0
	Q4	4.6	4.3	2.0	1.9	2.9	2.7	3.0	3.0	-0.0	0.0
FOUR-QUARTER[4]											
1994	Q4	5.9	5.9	3.5	3.5	2.3	2.3	2.7	2.7	-1.0	-1.0
1995	Q4	3.8	3.8	1.3	1.3	2.5	2.5	2.6	2.6	0.0	0.0
1996	Q4	5.0	5.0	3.2	3.1	2.1	2.1	3.2	3.2	-0.3	-0.3
1997	Q4	5.2	5.3	2.8	3.1	2.5	2.4	2.5	2.4	-0.3	-0.5
1998	Q4	4.7	4.4	2.1	2.0	2.8	2.7	3.0	2.9	-0.1	0.0

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.

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Class II FOMC

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

May 15, 1997

Item	Units[1]	1990	1991	1992	1993	1994	1995	1996	- Projected - 1997	1998
EXPENDITURES										
Nominal GDP	Bill. $	5743.8	5916.7	6244.4	6553.0	6935.7	7253.8	7576.1	7991.7	8344.8
Real GDP	Bill. Ch. $	6136.3	6079.4	6244.4	6386.1	6608.4	6742.2	6906.8	7151.5	7303.4
Real GDP	% change	-0.2	0.4	3.6	2.2	3.5	1.3	3.1	3.1	2.0
Gross domestic purchases		-0.8	0.0	4.0	2.9	3.7	1.0	3.3	3.8	2.2
Final sales		0.6	-0.4	3.9	2.0	2.9	1.9	3.1	3.0	2.0
Priv. dom. final purchases		-0.7	-0.8	4.9	3.4	4.0	2.3	3.6	4.3	2.7
Personal cons. expenditures		0.5	-0.2	4.2	2.5	3.1	1.9	2.7	3.6	2.6
Durables		-3.2	-3.1	9.4	7.3	7.0	1.3	5.4	7.2	4.3
Nondurables		-0.5	-1.0	3.4	1.5	3.5	1.1	1.8	3.1	2.3
Services		2.0	0.9	3.6	2.1	2.0	2.4	2.6	2.9	2.2
Business fixed investment		-2.5	-6.0	5.5	8.5	10.1	6.4	9.5	10.2	5.6
Producers' dur. equipment		-2.0	-2.6	9.6	11.5	12.6	6.9	9.7	11.6	6.0
Nonres. structures		-3.5	-12.5	-3.4	1.5	3.7	5.1	9.0	6.5	4.4
Residential structures		-15.1	1.1	16.9	8.1	5.7	-1.5	3.8	1.0	-1.9
Exports		7.2	8.6	4.1	4.8	9.9	7.4	7.4	7.0	6.9
Imports		0.5	4.1	7.4	10.5	11.8	4.2	8.3	11.9	8.1
Gov't. cons. & investment		2.6	-0.7	1.7	-0.5	0.0	-1.3	1.9	1.1	0.1
Federal		1.6	-3.1	1.3	-5.4	-3.1	-6.7	1.5	-1.0	-3.9
Defense		0.3	-5.3	-1.3	-6.8	-5.7	-6.8	0.2	-1.4	-4.2
State & local		3.3	1.0	2.0	3.1	2.2	2.1	2.1	2.4	2.4
Change in bus. inventories	Bill. Ch. $	10.4	-3.0	7.0	19.0	58.9	32.7	13.6	39.9	30.8
Nonfarm		7.8	-1.2	2.0	26.4	46.8	37.2	17.1	39.0	28.8
Net exports		-61.9	-22.3	-29.5	-72.0	-105.7	-107.6	-113.6	-145.4	-173.3
Nominal GDP	% change	4.4	3.8	6.3	4.8	5.9	3.8	5.0	5.3	4.4
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	109.4	108.3	108.6	110.7	114.2	117.2	119.5	122.0	123.8
Unemployment rate	%	5.6	6.8	7.5	6.9	6.1	5.6	5.4	5.0	4.8
Industrial prod. index	% change	-0.6	-0.0	3.9	3.0	5.7	1.8	3.9	3.9	2.0
Capacity util. rate - mfg.	%	81.4	78.0	79.5	80.8	83.1	83.1	82.1	82.5	82.1
Housing starts	Millions	1.19	1.01	1.20	1.29	1.46	1.35	1.48	1.42	1.35
Light motor vehicle sales		14.05	12.52	12.85	13.87	15.02	14.77	15.03	15.09	14.91
North Amer. produced		10.85	9.74	10.51	11.72	12.88	12.85	13.32	13.20	13.10
Other		3.20	2.77	2.34	2.15	2.13	1.91	1.70	1.90	1.81
INCOME AND SAVING										
Nominal GNP	Bill. $	5764.9	5932.4	6255.5	6563.5	6931.9	7246.7	7567.1	7969.4	8310.9
Nominal GNP	% change	4.6	3.5	6.2	4.7	5.7	3.9	4.9	5.1	4.3
Nominal personal income		6.4	3.7	7.3	3.6	4.9	5.6	5.7	5.3	4.9
Real disposable income		1.1	0.8	4.0	0.9	2.4	3.1	2.7	3.0	2.7
Personal saving rate	%	5.3	6.0	6.2	4.8	4.0	4.6	4.9	4.8	4.7
Corp. profits, IVA & CCAdj.	% change	5.5	4.5	11.3	18.8	9.6	6.2	6.7	10.0	0.6
Profit share of GNP	%	6.9	6.9	6.8	7.5	8.0	8.3	8.9	9.3	8.9
Excluding FR Banks	%	6.5	6.6	6.6	7.3	7.7	8.0	8.6	9.0	8.6
Federal surpl./deficit	Bill. $	-154.7	-196.0	-280.9	-255.6	-190.2	-161.7	-127.1	-76.4	-86.3
State & local surpl./def.		80.1	75.8	86.3	94.9	99.7	95.0	93.0	96.0	92.5
Ex. social ins. funds		20.2	11.5	18.3	28.0	36.9	36.8	37.4	43.4	40.7
PRICES AND COSTS										
GDP implicit deflator	% change	4.7	3.4	2.6	2.5	2.4	2.4	1.7	2.1	2.3
GDP chn.-wt. price index		4.7	3.3	2.6	2.5	2.3	2.5	2.1	2.4	2.7
Gross Domestic Purchases chn.-wt. price index		5.2	2.7	2.7	2.3	2.4	2.3	2.2	2.1	2.6
CPI		6.3	3.0	3.1	2.7	2.7	2.6	3.2	2.4	2.9
Ex. food and energy		5.3	4.4	3.5	3.1	2.8	3.0	2.6	2.7	3.1
ECI, hourly compensation[2]		4.6	4.4	3.5	3.6	3.1	2.6	3.1	3.4	3.6
Nonfarm business sector										
Output per hour		-0.6	2.2	3.6	-0.3	0.3	-0.1	0.9	1.2	0.9
Compensation per Hour		5.8	4.8	4.6	1.8	2.3	3.7	3.6	3.7	3.8
Unit labor cost		6.4	2.5	1.0	2.1	2.0	3.7	2.6	2.5	2.9

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

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Class II FOMC

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

May 15, 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. $	6776.1	6890.5	6993.1	7083.2	7149.8	7204.9	7309.8	7350.6	7426.8	7545.1
Real GDP	Bill. Ch. $	6508.5	6587.4	6644.8	6692.9	6700.2	6712.7	6775.8	6780.2	6813.8	6892.1
Real GDP	% change	2.5	4.9	3.5	2.9	0.4	0.7	3.8	0.3	2.0	4.7
Gross domestic purchases		3.5	5.3	3.7	2.4	1.5	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		3.8	4.4	3.8	4.0	2.2	2.3	3.1	1.5	4.6	4.0
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. $	40.8	74.7	64.6	55.6	53.7	29.9	33.5	13.7	-3.5	6.7
Nonfarm		29.7	54.0	50.5	53.0	57.4	33.7	38.5	19.0	2.9	11.7
Net exports		-99.3	-107.3	-111.7	-104.4	-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	6986.9	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		-2.2	11.2	4.6	6.4	7.2	4.7	4.8	5.7	4.9	6.8
Real disposable income		-4.0	7.4	2.6	3.8	3.7	0.2	4.3	4.3	2.0	1.4
Personal saving rate	%	3.3	4.2	4.1	4.2	4.8	4.1	4.5	5.1	4.8	4.3
Corp. profits, IVA & CCAdj.	% change	-33.6	74.5	12.9	10.4	-7.7	0.6	38.4	-1.1	22.6	6.8
Profit share of GNP	%	7.2	8.1	8.3	8.4	8.1	8.1	8.6	8.6	8.9	8.9
Excluding FR Banks	%	6.9	7.9	8.0	8.1	7.8	7.8	8.3	8.3	8.6	8.6
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	2.3	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	2.6	3.2	3.4
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	2.6	2.6	2.9	2.5	3.5
Nonfarm business sector											
Output per hour		-1.8	1.0	1.7	0.4	-2.2	1.5	1.7	-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)

May 15, 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	7716.1	7867.9	7942.9	8033.4	8122.4	8211.8	8300.9	8388.4	8478.0
Real GDP	Bill. Ch. $	6928.1	6993.3	7095.3	7126.7	7171.6	7212.5	7250.2	7286.9	7320.9	7355.8
Real GDP	% change	2.1	3.8	6.0	1.8	2.5	2.3	2.1	2.0	1.9	1.9
Gross domestic purchases		3.3	1.6	7.6	2.4	3.5	1.9	2.7	2.2	2.7	1.4
Final sales		0.5	4.9	3.8	2.6	2.3	3.4	1.8	2.0	1.6	2.7
Priv. dom. final purchases		2.3	3.3	6.7	3.5	3.7	3.2	2.9	2.7	2.6	2.7
Personal cons. expenditures		0.5	3.4	5.8	2.2	3.2	3.0	2.8	2.6	2.5	2.4
Durables		-2.6	5.0	17.7	-1.4	8.0	5.5	4.6	4.3	4.4	3.8
Nondurables		0.4	1.8	5.2	1.7	2.8	2.8	2.6	2.4	2.2	2.2
Services		1.3	3.8	3.6	3.3	2.2	2.4	2.3	2.2	2.1	2.1
Business fixed investment		17.5	5.5	12.2	12.2	9.6	6.9	5.6	5.6	5.7	5.5
Producers' dur. equipment		20.9	-0.9	14.0	13.9	11.0	7.5	6.0	6.0	6.2	5.9
Nonres. structures		8.4	25.8	7.7	7.6	5.7	5.0	4.5	4.5	4.3	4.1
Residential structures		-5.2	-1.8	6.4	1.3	-2.0	-1.6	-2.0	-2.5	-2.7	-0.2
Exports		-0.9	25.0	7.9	7.9	2.1	10.3	4.2	9.4	3.1	11.1
Imports		9.3	3.3	20.8	12.2	9.2	5.9	8.0	9.8	8.8	5.9
Gov't. cons. & investment		-0.6	-0.9	-0.1	2.0	1.3	1.4	-0.0	-0.1	1.2	-0.5
Federal		-3.5	-5.3	-3.5	1.2	-0.9	-0.7	-4.2	-4.6	-1.0	-5.8
Defense		-5.5	-6.9	-10.1	3.9	0.4	1.0	-5.5	-6.0	0.0	-5.1
State & local		1.1	1.9	1.9	2.5	2.5	2.6	2.4	2.4	2.4	2.4
Change in bus. inventories	Bill. Ch. $	34.1	17.1	52.3	39.0	42.8	25.4	30.8	31.3	36.8	24.4
Nonfarm		34.6	19.3	52.6	38.3	41.3	23.7	28.9	29.2	34.7	22.4
Net exports		-137.4	-98.4	-128.5	-141.0	-159.5	-152.5	-163.9	-168.6	-185.0	-175.8
Nominal GDP	% change	3.8	5.3	8.1	3.9	4.6	4.5	4.5	4.4	4.3	4.3
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	120.0	120.5	121.2	121.8	122.3	122.8	123.2	123.6	124.0	124.4
Unemployment rate	%	5.3	5.3	5.3	5.0	4.9	4.8	4.8	4.8	4.8	4.8
Industrial prod. index	% change	3.3	4.5	4.7	3.7	4.1	2.9	2.4	2.2	1.6	2.0
Capacity util. rate - mfg.	%	82.3	82.3	82.6	82.5	82.6	82.4	82.3	82.2	82.1	82.0
Housing starts	Millions	1.49	1.42	1.44	1.43	1.42	1.40	1.38	1.36	1.33	1.33
Light motor vehicle sales		15.07	14.82	15.45	14.78	15.11	15.03	14.92	14.91	14.90	14.89
North Amer. produced		13.38	13.07	13.50	12.91	13.22	13.15	13.10	13.10	13.10	13.10
Other		1.69	1.75	1.95	1.87	1.89	1.88	1.82	1.81	1.80	1.79
INCOME AND SAVING											
Nominal GNP	Bill. $	7598.9	7705.6	7851.1	7923.4	8008.4	8094.8	8184.0	8267.7	8352.3	8439.7
Nominal GNP	% change	3.3	5.7	7.8	3.7	4.4	4.4	4.5	4.2	4.2	4.3
Nominal personal income		5.7	5.4	7.3	4.7	4.6	4.7	5.2	4.5	4.5	5.4
Real disposable income		4.9	2.6	4.6	3.1	2.2	2.0	4.6	1.8	1.7	2.6
Personal saving rate	%	5.3	5.1	4.9	5.0	4.8	4.5	4.9	4.7	4.5	4.5
Corp. profits, IVA & CCAdj.	% change	3.1	-4.2	48.5	-0.4	-0.4	-0.5	1.8	-1.6	-1.4	3.7
Profit share of GNP	%	8.9	8.7	9.4	9.3	9.2	9.1	9.0	8.9	8.8	8.8
Excluding FR Banks	%	8.6	8.4	9.1	9.1	8.9	8.8	8.8	8.7	8.5	8.5
Federal surpl./deficit	Bill. $	-120.8	-105.9	-84.4	-78.1	-69.1	-73.9	-95.5	-87.4	-83.0	-79.2
State & local surpl./def.		89.2	90.9	96.3	96.9	95.6	95.2	94.5	93.7	92.5	89.5
Ex. social ins. funds		33.8	36.9	43.4	44.2	43.1	42.9	42.4	41.8	40.8	38.0
PRICES AND COSTS											
GDP implicit deflator	% change	1.7	1.5	2.2	2.1	2.0	2.2	2.3	2.3	2.4	2.4
GDP chn.-wt. price index		2.0	1.9	2.8	2.1	2.3	2.4	2.6	2.7	2.7	2.7
Gross Domestic Purchases chn.-wt. price index		1.9	2.6	2.3	1.4	2.3	2.5	2.6	2.5	2.6	2.6
CPI		2.8	3.3	2.3	1.2	2.7	3.1	2.8	2.9	3.0	3.0
Ex. food and energy		2.4	2.7	2.2	2.9	2.8	3.1	3.1	3.1	3.1	3.1
ECI, hourly compensation[1]		2.8	2.8	2.5	3.7	3.7	3.7	3.1	3.9	3.8	3.8
Nonfarm business sector											
Output per hour		0.0	1.1	2.6	0.7	0.8	0.9	1.0	0.9	0.8	0.8
Compensation per hour		3.3	3.6	4.7	3.0	3.4	3.9	3.8	3.8	3.8	3.8
Unit labor cost		3.3	2.5	2.0	2.3	2.6	3.0	2.8	2.9	3.0	3.0

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

May 15, 1997

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	3.8	6.0	1.8	2.5	2.3	2.1	2.0	1.9	1.9	3.1	3.1	2.0
Gross dom. purchases	1.6	7.7	2.4	3.6	1.9	2.7	2.3	2.8	1.4	3.3	3.9	2.3
Final sales	4.9	3.8	2.6	2.3	3.3	1.8	2.0	1.6	2.7	3.1	3.0	2.0
Priv. dom. final purchases	2.8	5.5	2.9	3.1	2.7	2.4	2.3	2.2	2.2	2.9	3.5	2.3
Personal cons. expenditures	2.3	3.9	1.5	2.2	2.0	1.9	1.8	1.7	1.7	1.8	2.4	1.8
Durables	0.4	1.5	-0.1	0.7	0.5	0.4	0.4	0.4	0.4	0.5	0.6	0.4
Nondurables	0.4	1.1	0.4	0.6	0.6	0.5	0.5	0.4	0.4	0.4	0.7	0.5
Services	1.5	1.3	1.2	0.8	0.9	0.9	0.8	0.8	0.8	1.0	1.1	0.8
Business fixed investment	0.6	1.3	1.3	1.1	0.8	0.7	0.7	0.7	0.7	1.0	1.2	0.7
Producers' dur. equip.	-0.1	1.1	1.1	0.9	0.7	0.5	0.5	0.6	0.6	0.8	1.0	0.6
Nonres. structures	0.7	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.1
Residential structures	-0.1	0.2	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.0	0.2	0.0	-0.1
Net exports	2.2	-1.7	-0.7	-1.0	0.4	-0.6	-0.3	-0.9	0.5	-0.2	-0.8	-0.3
Exports	2.6	0.9	1.0	0.3	1.3	0.5	1.2	0.4	1.4	0.9	0.9	0.9
Imports	-0.4	-2.7	-1.7	-1.3	-0.9	-1.2	-1.4	-1.3	-0.9	-1.1	-1.6	-1.2
Government cons. & invest.	-0.2	-0.0	0.4	0.2	0.3	-0.0	-0.0	0.2	-0.1	0.4	0.2	0.0
Federal	-0.4	-0.2	0.1	-0.1	-0.0	-0.3	-0.3	-0.1	-0.4	0.1	-0.1	-0.2
Defense	-0.3	-0.5	0.2	0.0	0.0	-0.2	-0.3	0.0	-0.2	0.0	-0.1	-0.2
Nondefense	0.0	0.2	-0.1	-0.1	-0.1	-0.0	-0.0	-0.1	-0.2	0.1	-0.0	-0.1
State and local	0.2	0.2	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	2.0	-0.7	0.2	-1.0	0.3	0.0	0.3	-0.7	0.1	0.1	-0.0
Nonfarm	-0.9	1.9	-0.8	0.2	-1.0	0.3	0.0	0.3	-0.7	0.0	0.1	-0.0
Farm	-0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0
GDP residual	-0.5	-0.1	-0.3	-0.3	-0.4	-0.3	-0.3	-0.3	-0.4	-0.3	-0.3	-0.3

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)

May 15, 1997

Item	Fiscal year[5]				1996				1997				1998			
	1995[a]	1996[a]	1997	1998	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[b]	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1352	1453	1570	1610	322	446	362	346	349	495	380	365	357	490	399	384
Outlays[1]	1516	1560	1627	1687	393	392	395	405	401	409	411	425	419	421	422	476
Surplus/deficit[1]	-164	-107	-57	-77	-72	54	-33	-59	-52	85	-31	-60	-62	68	-24	-91
On-budget	-226	-174	-136	-156	-84	14	-35	-77	-69	45	-35	-72	-75	22	-31	-104
Off-budget	62	67	79	79	12	39	2	18	17	41	4	12	14	47	7	12
Surplus excluding deposit insurance[2]	-182	-116	-69	-82	-75	52	-34	-66	-56	84	-32	-61	-63	67	-25	-92
Means of financing																
Borrowing	171	130	53	96	80	-23	39	49	48	-86	42	45	60	-48	40	68
Cash decrease	-2	-6	4	0	-1	-16	-6	11	-1	-7	0	10	10	-15	-5	10
Other[3]	-5	-16	0	-19	-7	-14	0	-1	5	8	-12	5	-8	-5	-11	13
Cash operating balance, end of period	38	44	40	40	22	38	44	33	33	40	40	30	20	35	40	30
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1459	1544	1661	1720	1523	1576	1582	1619	1653	1676	1697	1715	1704	1722	1739	1761
Expenditures	1629	1683	1746	1805	1678	1702	1703	1725	1737	1754	1766	1789	1799	1809	1822	1840
Consumption expend.	455	457	461	464	454	464	461	458	462	461	462	463	465	463	464	460
Defense	304	303	304	306	299	307	305	305	302	303	305	307	307	305	306	305
Nondefense	151	155	157	158	155	156	157	153	159	158	157	157	158	158	158	156
Other expenditures	1175	1226	1285	1341	1225	1239	1241	1268	1276	1293	1304	1326	1334	1346	1358	1379
Current account surplus	-171	-139	-84	-85	-155	-127	-121	-106	-84	-78	-69	-74	-95	-87	-83	-79
Gross investment	65	63	62	64	65	66	64	61	58	63	64	65	64	63	64	63
Current and capital account surplus	-236	-202	-146	-149	-220	-193	-185	-167	-143	-141	-133	-139	-159	-150	-147	-142
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-257	-228	-213	-235	-239	-226	-221	-214	-210	-215	-213	-223	-245	-238	-234	-231
Change in HEB, percent of potential GDP	-.1	-.4	-.2	.3	.1	-.2	-.1	-.1	-.1	.1	0	.1	.3	-.1	-.1	0
Fiscal impetus (FI), percent, cal. year	-5.5	-2	-2.5	-1.9	1.3	1.8	-.4	-2.2	-.2	-.7	-.2	-1.3	1	-1.3	-.4	-2.3

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.

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

			Nonfederal						Memo:
				Households					
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	4.7	1.3	5.9	6.4	6.9	6.1	6.2	1.7	5.3
1998	5.1	3.1	5.7	6.0	6.3	6.0	6.3	1.9	4.4
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	6.4	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	4.5	3.1	4.9	5.6	6.5	5.5	3.6	6.9	5.3
1997:1	4.9	2.5	5.7	6.5	6.9	6.2	6.0	0.7	8.1
2	3.6	-4.0	6.2	6.3	6.8	5.9	6.5	4.7	3.9
3	4.9	4.3	5.2	6.1	6.7	5.9	5.7	-1.7	4.6
4	5.0	2.5	5.8	6.1	6.6	5.8	6.1	3.1	4.5

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 grew 5.4 percent in 1996, 4.6 percent in 1997, and 5.0 percent in 1998.
3. On a monthly average basis, federal debt rose 3.8 percent in 1996, 1.4 percent in 1997, and 2.8 percent in 1998.
4. On a monthly average basis, nonfederal debt increased 5.9 percent in 1996, 5.7 percent in 1997, and 5.7 percent in 1998.

2.6.3 FOF

Strictly Confidential Class II FOMC
May 15, 1997

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

					Seasonally adjusted annual rates							
	Calendar year				1996		1997				1998	
Category	1995	1996	1997	1998	Q3	Q4	Q1	Q2	Q3	Q4	H1	H2
Net funds raised by domestic nonfinancial sectors												
1 Total	645.6	664.8	590.4	684.2	586.2	575.0	630.6	461.0	627.5	642.3	647.9	720.5
2 Net equity issuance	-74.2	-82.6	-95.6	-90.8	-138.8	-72.0	-84.8	-74.0	-112.8	-110.8	-89.0	-92.6
3 Net debt issuance	719.8	747.4	686.0	775.0	725.0	647.0	715.4	535.0	740.3	753.1	736.9	813.1
Borrowing sectors												
Nonfinancial business												
4 Financing gap [1]	57.7	20.3	51.0	81.6	29.9	43.5	34.6	50.4	62.8	56.1	74.8	88.4
5 Net equity issuance	-74.2	-82.6	-95.6	-90.8	-138.8	-72.0	-84.8	-74.0	-112.8	-110.8	-89.0	-92.6
6 Credit market borrowing	233.8	193.9	269.1	289.3	249.5	155.5	259.1	286.9	253.1	277.3	282.8	295.7
Households												
7 Net borrowing [2]	381.1	395.3	348.8	345.2	375.7	301.1	354.7	349.0	344.8	346.7	342.7	347.7
8 Home mortgages	197.7	278.7	252.2	247.2	255.8	234.7	252.2	252.2	252.2	252.2	247.2	247.2
9 Consumer credit	141.6	94.4	74.7	77.5	98.0	66.2	76.1	73.3	74.3	75.0	76.5	78.5
10 Debt/DPI (percent) [3]	91.2	93.9	95.4	96.4	94.5	94.9	94.8	95.2	95.7	96.1	96.1	96.8
State and local governments												
11 Net borrowing	-39.6	13.3	18.8	20.9	-61.6	73.9	7.8	51.4	-18.6	34.6	34.4	7.4
12 Current surplus [4]	108.4	116.2	118.7	115.6	113.9	112.0	117.7	114.5	123.3	119.2	116.7	114.5
Federal government												
13 Net borrowing	144.4	145.0	49.2	119.6	161.3	116.5	93.7	-152.3	161.0	94.5	77.0	162.3
14 Net borrowing (quarterly, n.s.a.)	144.4	145.0	49.2	119.6	39.3	48.7	48.0	-86.0	42.4	44.8	11.4	108.2
15 Unified deficit (quarterly, n.s.a.)	146.3	110.6	57.4	108.7	33.0	59.3	52.0	-85.3	30.8	59.9	-6.5	115.2
Depository institutions												
16 Funds supplied	274.6	233.4	255.3	267.9	265.2	220.5	213.3	335.4	215.4	257.2	258.1	277.7
Memo (percentage of GDP)												
17 Domestic nonfinancial debt [5]	186.6	188.3	187.5	188.4	189.0	188.7	187.3	187.5	187.3	187.6	187.9	188.6
18 Domestic nonfinancial borrowing	9.9	9.9	8.6	9.3	9.5	8.4	9.1	6.7	9.2	9.3	8.9	9.6
19 Federal government [6]	2.0	1.9	0.6	1.4	2.1	1.5	1.2	-1.9	2.0	1.2	0.9	1.9
20 Nonfederal	7.9	8.0	8.0	7.9	7.4	6.9	7.9	8.7	7.2	8.1	8.0	7.7

Note. Data after 1996:Q4 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. 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 declined 1 percent since the March FOMC meeting. The dollar rose strongly in April on expectations of a further U.S. monetary tightening, but it has fallen back in May as those expectations have ebbed and as market attention focused on G-7 officials' concerns about exchange rates.

The dollar has depreciated 5-1/2 percent, on balance, against the yen but has firmed slightly against major European currencies and the Canadian dollar. European long-term interest rates have declined 20 basis points (Germany) to 60 basis points (Italy and the United Kingdom). Japanese long-term rates have risen 20 basis points on perceptions of some firming in Japanese economic activity. Short-term rates have changed little in most cases. The Canadian dollar weakened when the Bank of Canada did not follow the firming move by the Federal Reserve in March. Sterling rose slightly late in the period and U.K. long-term interest rates fell sharply after the new Labour government announced that the repo rate was raised 25 basis points to 6-1/4 percent and that henceforth the Bank of England would be given authority to set official interest rates.

Considerable market attention has been focused on the prospects for official intervention to restrain the dollar, especially late in the period in response to remarks by German and Japanese officials expressing concern about the weakness of their currencies against the dollar.

. The Desk did not intervene.

Data for the first quarter and some preliminary indicators for the second quarter suggest that the growth of output has strengthened somewhat on average in the foreign G-7 countries. Activity has been strong in the United Kingdom, Canada, and Japan, and weak but improving in continental Europe. U.K. GDP rose at an annual rate of 4 percent in the first quarter, and business sentiment was strong through April. Canadian industrial production and retail sales strengthened substantially in January-February and employment showed further gains through April. Recent data on activity in Japan have been distorted by the April 1 hike in the consumption tax, with strong activity in the first quarter followed by some weakening in April. German industrial production turned up moderately in the first quarter, and export orders surged. French consumption of manufactured goods grew modestly in the first quarter, and Italian industrial output bounced back from sharp declines during the second half of 1996.

The twelve-month rate of consumer price inflation receded to 2.5 percent in the United Kingdom in April as a result of declines in oil and food prices. CPI inflation ranged between 1 percent and 2 percent in the other foreign G-7 countries. As expected, Japanese inflation rose to a bit more than 1 percent in April reflecting the consumption tax increase. Italian inflation declined to 1.7 percent in April, helped by the appreciation of the lira over the past year.

Economic activity continued to expand rapidly during the first quarter in major developing countries on average. Growth of industrial production slowed somewhat in Latin America and China but picked up in Korea and Taiwan. Mexico's trade surplus widened in the first quarter after having dipped to near zero in the fourth.

The nominal U.S. trade deficit on goods and services widened substantially in January-February, fully reversing the large decline that occurred in the fourth quarter. Exports of goods and services rose only slightly from their very strong fourth-quarter level. Automotive exports recovered from strike-depressed levels of the fourth quarter, but shipments of other goods (most notably aircraft and agricultural commodities) dropped, though less than we had expected they would. At the same time, imports, led by a surge in computers and semiconductors and a rebound in autos from Canada and Mexico after the GM strike ended, rose even more rapidly than we had anticipated. Oil imports fell in January-February as prices declined and volumes rose only slightly. Preliminary Department of Energy statistics for March and April indicate that the volume of oil imports rose as stocks were rebuilt. Oil prices continued their rapid descent, however; the spot WTI price fell to just below $20 per barrel in April--and remained there in early May--reversing most of the 1996 runup. Deliveries from Iraq and mild weather tended to quell the oil market. Prices jumped to $21 per barrel toward the end of the period because of increased tensions in the Middle East.

The prices of non-oil imports fell moderately in the first quarter (for the sixth consecutive quarter) as modest inflation abroad and the effects of the appreciation of the dollar showed through. Declines in the prices of imported computers and semiconductors accelerated in the first quarter. Export prices rose moderately, with higher grain and oilseed prices.

Outlook

The staff projection is little changed from that in the March Greenbook. Real output in our foreign trading partners (weighted by bilateral shares in U.S. nonagricultural exports) is expected to grow at about a 4 percent rate this year and next. We project the dollar to drift down slightly over the forecast period. We have revised up slightly the growth of real imports and exports, but the downward trajectory of real net exports remains about the same as it was in March. Real net exports subtract about 3/4 percentage point from the annual rate of GDP growth in the current quarter and about half that over the balance of 1997 and in 1998.

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

Measure	1997				1998
	Q1	Q2	Q3	Q4	
Foreign output	4.0	3.9	3.9	3.9	3.9
Previous	3.9	4.1	3.9	3.9	3.8
Real exports	7.9	7.9	2.1	10.3	6.9
Previous	4.3	6.7	2.1	11.4	6.5
Real imports	20.9	12.2	9.2	5.9	8.1
Previous	16.0	10.9	8.0	9.2	7.8

The dollar. We project that the foreign exchange value of the dollar in terms of the other G-10 currencies will weaken gradually over the forecast period as widening U.S. current account deficits and Japanese current account surpluses depress the dollar, particularly against the yen. 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 about 3 percent at an annual rate during the first half of 1997 and a little less over the rest of the forecast period. Growth rates are projected to be somewhat above potential (except in Italy), but unemployment should nevertheless remain high in continental Europe.

Notwithstanding the difficulty of interpreting recent data in Japan, indicators seem to have been slightly stronger than we had anticipated, and we have added a tenth or two to Japanese GDP growth over the forecast period. We still expect growth to slow in the current quarter in the wake of the consumption tax increase and then to pick up to a 2-1/2 percent rate next year, somewhat less than last year's pace.

Growth will be held back this year by more contractionary fiscal policy and will pick up over the forecast period as net exports strengthen, notwithstanding the recent and anticipated further appreciation of the yen.

GDP in Germany and France should rebound in the current quarter from levels depressed by poor weather earlier this year. We expect growth to be in the range of 2 percent to 3 percent over the rest of the forecast period, led by net exports and investment. The projected recovery in Italy lags behind the expansions in Germany and France because of the relatively large Italian fiscal contraction.

The continued strength of sterling has led us to shade down our projection of U.K. GDP growth over the forecast period, and the recent and expected further monetary tightening in that country should help to slow growth to near its potential rate of a little over 2 percent. In Canada, continued rapid growth in investment spending and relatively strong consumer demand should support vigorous output expansion over the forecast period.

Inflation in the foreign G-7 countries (weighted by bilateral U.S. non-oil import shares) is projected to rise a bit on average this year 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, average inflation in the foreign G-7 countries should again edge below a 1-1/2 percent rate.

The forecast assumes that the average level of short-term interest rates in foreign G-7 countries will be little changed for the balance of 1997 as rates in Italy recede somewhat further and those in the United Kingdom are raised again. We expect rates in 1998 to rise more broadly with economic recoveries gaining momentum in most of the foreign G-7 countries. We assume long-term rates will change little on balance over the forecast period, with higher rates in some countries, particularly Japan, offset by some further declines in Italian rates. Italy's interest rates should decline further as that country's expansion lags and as Italy benefits from moving closer to EMU membership, but its rates will remain well above those in Germany and France until its membership in EMU is assured.[1]

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1. Our forecast continues to assume that Stage Three of the European Monetary Union will move ahead as scheduled on January 1, 1999, at least with Germany, France, and several smaller European countries included. Prospects for Italy's inclusion at this stage remain clouded by uncertainty about the outlook for that country's budget deficits this year and next. Current budget plans in Italy (including a recent supplemental budget) may well put the 1997 deficit close enough to 3 percent to allow for an affirmative political decision on initial EMU entry. Based on budget performance alone, Portugal and Spain appear to have a stronger claim than Italy to being included as initial members.

Other countries. We project that real GDP in our major developing-country trading partners will increase at an annual rate of slightly less than 6 percent in 1997-98, a forecast about the same as that in the March Greenbook.

Real GDP in Latin America is expected to expand about 4-1/2 percent per year. We expect growth in Mexico to remain relatively strong during 1997 and to slow a bit in 1998. With strong GDP growth and a rise in the value of the peso in real terms, Mexico's current account deficit is projected to widen from less than $2 billion in 1996 to $6 billion in 1997. Prospects for growth in Argentina this year have strengthened somewhat in recent weeks given news of a record agricultural harvest, while growth in Brazil is still expected to be in the vicinity of 3 percent.

Real output in our major trading partners in Asia is expected to expand at a 6-1/2 to 7 percent rate, a bit less than we projected in March because of downward revisions to our forecasts for Taiwan and South Korea. In the case of Taiwan, "foot-and-mouth" disease in pig supplies will noticeably reduce exports and GDP in the near term. In South Korea, an unfolding financial scandal and the near-bankruptcies of two leading conglomerates have had an unsettling effect on business confidence. Problems in Thailand manifested recently in exchange rate pressures could potentially have some spillover effects on other economies, especially in Asia.

We project growth to remain near 10 percent per year in China and 5-1/2 percent in Hong Kong, assuming the upcoming return of Hong Kong to China on July 1 does not disrupt ongoing financial and commercial relations. Financial markets appear sanguine about the near-term prospects for Hong Kong.

We are expecting inflation in Mexico to continue to recede toward single-digit levels over the forecast period. Inflation pressures could begin to build elsewhere, however, particularly among some of the rapidly growing Asian economies.

U.S. real exports and imports. We project real exports of goods and services to grow at about a 7 percent annual rate this year and next. Core exports (goods other than agricultural products, computers, and semiconductors) are projected to slow from about a 4 percent expansion this year to 2 percent next year, reflecting the lagged response of these exports to the appreciation of the dollar over the past year. The slowdown in core exports is offset by a speedup of agricultural shipments next year and faster growth in service receipts. Service receipts, which tend to respond to exchange rate changes with a shorter lag than core exports, should be depressed this year but not next by the appreciation of the dollar. The projected growth of total exports is elevated by the continued rapid expansion of real exports of computers and semiconductors.

The growth of real imports of goods and services should come off its first-quarter highs as the expansion of U.S. domestic demand slows. Nevertheless, import demand will continue to be stimulated for much of this year by recent declines in the relative price of imports stemming from the strong dollar. Imports of computers and semiconductors will slow from the exceptionally rapid expansion seen in the first quarter but are nevertheless expected to continue growing strongly. On balance, we see the growth of total imports slowing from an annual rate of 9 percent during the last three quarters of 1997 to 8 percent in 1998.

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

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

Trade category	Projection				
	1997				1998
	Q1	Q2	Q3	Q4	
Exports					
Nonagricultural	-.8	-2.8	.1	.8	1.1
Agricultural	.7	3.2	2.3	2.0	1.3
Imports					
Non-oil	-2.4	-2.1	1.9	2.5	.6
Oil (level, dollars per barrel)	21.37	17.82	17.22	17.10	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.

Oil prices. The staff's projection for the price of imported oil is basically the same as in the March Greenbook. We project the WTI spot price and the oil import unit value to be near \$19.50/b and \$17.00/b, respectively, through 1998.

Prices of non-oil imports and exports. The appreciation of the dollar through early May has had the beneficial effect of holding down the prices of non-oil imports.

Given the more recent depreciation and our projection of a gradual further decline in the dollar, this beneficial effect will reverse. Prices of non-oil imports should drop further in the current quarter as a result of the past appreciation of the dollar, but we expect these prices to pick up noticeably in the second half of the year--not just because of the recent depreciation of the dollar, but also because of increases in coffee and metals prices. In 1998, a downturn in commodity prices and the projected slower rate of depreciation of the dollar should damp the increase in non-oil import prices next year to a rate below the increase in domestic prices.

Prices of nonagricultural exports are projected to decline somewhat through 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 rise moderately.

Nominal trade and current account balances. The nominal trade deficit for goods and services is projected to widen over the forecast period from a little more than $105 billion in the fourth quarter of 1996 to nearly $150 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 $225 billion, or 2-3/4 percent of GDP, in 1998.

Strictly Confidential (FR)
Class II FOMC

May 15, 1997

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	3.5	3.2
France	1.2	1.3	0.1	-0.6	4.4	0.3	2.0	2.8	2.4
Germany (1)	6.8	3.3	1.0	-0.2	3.4	0.8	2.2	2.2	2.9
Italy	0.7	1.9	-0.8	0.1	2.7	2.5	0.1	1.5	2.1
Japan	5.1	2.5	0.1	0.4	0.8	2.6	3.1	2.3	2.5
United Kingdom	-0.7	-1.5	0.3	2.8	4.2	1.9	2.6	2.7	2.4
Average weighted by 1987-89 GDP	2.7	2.8	0.2	0.7	2.8	1.7	2.2	2.4	2.5
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	3.9	3.9
Foreign G-7	0.6	1.5	0.3	1.8	3.8	1.3	2.4	2.9	2.8
Developing Countries	6.2	6.4	5.1	6.0	7.0	2.1	6.8	5.8	5.8
CONSUMER PRICES									
Canada	4.9	4.1	1.8	1.8	0.0	2.1	2.0	1.4	1.6
France	3.5	3.0	1.8	2.1	1.6	1.9	1.7	1.4	1.9
Germany (1)	3.0	4.0	3.4	4.2	2.6	1.7	1.4	1.6	1.6
Italy	6.4	6.1	4.9	4.1	3.8	5.9	2.7	2.0	2.0
Japan	3.2	3.2	0.9	1.2	0.8	-0.8	0.1	1.5	0.7
United Kingdom (2)	9.2	5.7	3.7	2.7	2.2	2.9	3.2	2.6	2.8
Average weighted by 1987-89 GDP	4.7	2.6	2.4	2.5	1.8	1.7	1.5	1.7	1.6
Average weighted by share of U.S. non-oil imports	4.3	2.8	1.9	2.0	1.0	1.1	1.3	1.6	1.4

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

Strictly Confidential (FR) May 15, 1997
Class II FOMC

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	3.8	3.4	3.5	3.3	3.2	3.2	3.2	3.1
France	5.3	-0.9	3.1	0.7	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	1.4	3.5	2.0	2.1	2.8	2.9	3.0	2.7
Italy	0.8	-1.5	2.2	-0.9	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	3.4	1.4	2.1	2.3	2.5	2.5	2.6	2.5
United Kingdom	2.5	2.1	2.6	3.4	3.9	2.3	2.4	2.3	2.2	2.4	2.5	2.4
Average weighted by 1987-89 GDP	4.0	0.7	2.3	2.0	2.5	2.5	2.3	2.3	2.5	2.5	2.6	2.5
Average weighted by share of U.S. nonagricultural exports												
Total foreign	4.8	1.8	4.6	4.9	4.0	3.9	3.9	3.9	4.0	3.9	3.9	3.7
Foreign G-7	3.0	1.2	2.7	2.6	3.2	2.9	2.9	2.8	2.8	2.8	2.9	2.8
Developing Countries	9.0	1.6	7.7	9.3	5.7	5.8	5.8	5.8	5.9	5.9	5.8	5.8
CONSUMER PRICES (1)												
Canada	1.4	1.4	1.4	2.0	2.1	1.7	1.8	1.4	1.4	1.5	1.6	1.6
France	2.1	2.4	1.8	1.7	1.5	1.1	1.4	1.4	1.6	1.6	1.8	1.9
Germany	1.6	1.5	1.4	1.4	1.7	1.7	1.7	1.6	1.7	1.6	1.6	1.6
Italy	5.0	4.2	3.5	2.7	2.4	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Japan	-0.3	0.1	0.0	0.1	0.0	1.3	1.5	1.5	1.7	0.2	0.5	0.7
United Kingdom (2)	2.9	2.8	2.9	3.2	2.9	2.9	2.8	2.6	2.6	2.7	2.8	2.8
Average weighted by 1987-89 GDP	1.7	1.7	1.5	1.5	1.4	1.7	1.8	1.7	1.8	1.3	1.5	1.6
Average weighted by share of U.S. non-oil imports	1.1	1.2	1.1	1.3	1.3	1.6	1.7	1.6	1.7	1.1	1.3	1.4

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1990	1991	1992	1993	1994	1995	---- Projected ---- 1996	1997	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	0.9	0.9
Imports of G&S	-0.0	-0.4	-0.8	-1.1	-1.4	-0.5	-1.1	-1.6	-1.2
	Percentage change, Q4/Q4								
Exports of G&S	7.2	8.6	4.1	4.8	9.9	7.4	7.4	7.0	6.9
Services	8.9	7.1	-0.9	3.9	4.8	5.1	3.0	2.3	3.6
Agricultural Goods	-7.3	10.1	10.4	-5.4	17.1	-3.0	3.8	-4.5	3.7
Computers	12.3	21.7	25.2	22.7	28.8	49.5	32.7	44.3	36.0
Semiconductors	61.5	41.8	64.8	45.1	68.7	29.7	4.9	28.1	27.4
Other Goods 1/	6.0	7.0	2.3	3.6	7.4	5.3	7.7	4.3	1.8
Imports of G&S	0.5	4.1	7.4	10.5	11.8	4.2	8.3	11.9	8.1
Services	5.8	-2.7	1.5	3.6	0.8	4.1	4.7	5.6	2.5
Oil	-15.8	8.1	12.1	10.1	-0.2	0.9	-1.9	8.5	4.5
Computers	2.9	35.9	45.1	38.8	37.3	43.8	23.9	40.3	28.7
Semiconductors	60.9	55.3	42.0	44.9	47.4	57.1	-13.6	47.7	31.1
Other Goods 2/	-0.3	2.5	5.4	9.5	12.5	-1.2	10.1	8.0	4.4
	Billions of chained 1992 dollars								
Net Goods & Services	-61.9	-22.3	-29.5	-72.0	-105.7	-107.6	-113.6	-145.4	-173.3
Exports of G&S	564.4	599.9	639.4	658.2	712.0	775.4	825.9	900.0	958.8
Imports of G&S	626.3	622.2	668.9	730.2	817.6	883.0	939.5	1045.4	1132.1
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-94.7	-9.5	-62.6	-99.9	-148.4	-148.2	-165.3	-195.1	-225.5
Net Goods & Services (BOP)	-80.3	-29.9	-38.3	-72.0	-104.4	-105.1	-114.4	-132.0	-150.9
Exports of G&S (BOP)	536.8	580.7	617.7	643.0	698.3	786.5	835.3	889.5	937.5
Imports of G&S (BOP)	617.1	610.6	655.9	715.0	802.7	891.6	949.7	1021.5	1088.4
Net Investment Income	20.9	15.8	11.2	9.7	-4.2	-8.0	-8.4	-21.3	-32.9
Direct, Net	55.9	55.6	51.6	55.9	47.4	57.5	64.4	68.9	72.4
Portfolio, Net	-35.0	-39.8	-40.4	-46.2	-51.6	-65.5	-72.9	-90.2	-105.3
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.

Strictly Confidential (FR) May 15, 1997
Class II FOMC

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	-0.5
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	5.7	-0.9	25.0
Services	0.8	9.7	3.4	5.5	-1.1	4.0	18.7	-0.2	2.6	3.0	-4.0	10.8
Agricultural Goods	-24.4	6.8	43.0	62.9	-0.6	-19.8	16.4	-4.5	9.2	-34.1	9.1	48.1
Computers	24.5	16.6	27.6	48.6	33.0	30.1	79.0	61.1	58.8	20.6	18.6	36.7
Semiconductors	131.4	16.2	45.8	106.7	43.6	19.9	28.8	27.6	-0.0	-20.7	2.6	48.8
Other Goods 1/	-6.6	20.2	6.6	11.0	0.0	7.6	0.7	13.4	-4.1	14.1	-2.8	26.7
Imports of G&S	8.2	18.4	10.7	10.3	11.2	4.5	-0.0	1.6	10.6	10.0	9.3	3.3
Services	1.8	7.5	-1.6	-4.0	21.7	-6.7	5.8	-2.4	13.0	1.1	2.5	2.5
Oil	-8.6	27.2	33.5	-36.2	-2.4	5.3	22.0	-17.3	-21.8	59.2	7.3	-30.6
Computers	45.0	30.9	24.8	49.9	29.6	31.9	64.7	51.8	27.8	22.9	22.1	22.9
Semiconductors	65.3	7.3	43.4	85.8	49.3	61.0	76.4	43.6	4.6	-38.5	-19.0	6.8
Other Goods 2/	7.0	19.9	9.5	14.1	6.9	2.4	-10.8	-2.2	12.3	11.7	11.8	4.6
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	-98.4
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	862.9
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	-166.2
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	-106.1
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	822.9	862.2
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	968.2
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

May 15, 1997

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1996				Projected 1997				Projected 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	-1.7	-0.7	-1.0	0.4	-0.6	-0.3	-0.9	0.5
Exports of G&S	0.2	0.7	-0.1	2.7	0.9	1.0	0.3	1.2	0.5	1.2	0.4	1.4
Imports of G&S	-1.3	-1.3	-1.2	-0.5	-2.7	-1.7	-1.3	-0.9	-1.2	-1.4	-1.3	-0.9
Percentage change from previous period, SAAR												
Exports of G&S	1.8	5.7	-0.9	25.0	7.9	7.9	2.1	10.3	4.2	9.4	3.1	11.1
Services	2.6	3.0	-4.0	10.8	3.5	1.3	1.9	2.7	3.6	3.8	3.6	3.4
Agricultural Goods	9.2	-34.1	9.1	48.1	-24.7	-13.4	10.8	15.2	3.3	3.3	2.4	5.7
Computers	58.8	20.6	18.6	36.7	82.4	33.5	33.5	33.5	36.0	36.0	36.0	36.0
Semiconductors	-0.0	-20.7	2.6	48.8	33.8	26.3	26.3	26.3	27.4	27.4	27.4	27.4
Other Goods 1/	-4.1	14.1	-2.8	26.7	5.0	8.9	-4.8	8.6	-2.4	6.5	-5.1	8.8
Imports of G&S	10.6	10.0	9.3	3.3	20.9	12.2	9.2	5.9	8.0	9.8	8.8	5.9
Services	13.0	1.1	2.5	2.5	10.6	5.3	4.0	2.7	2.4	2.5	2.4	2.6
Oil	-21.8	59.2	7.3	-30.6	24.1	33.7	14.1	-26.8	6.3	40.8	15.6	-31.2
Computers	27.8	22.9	22.1	22.9	85.4	31.1	26.3	26.3	28.7	28.7	28.7	28.7
Semiconductors	4.6	-38.5	-19.0	6.8	82.0	46.4	36.1	31.1	31.1	31.1	31.1	31.1
Other Goods 2/	12.3	11.7	11.8	4.6	13.3	7.7	5.9	5.2	4.6	4.5	4.4	4.3
Billions of chained 1992 dollars												
Net Goods & Services	-104.0	-114.7	-137.4	-98.4	-128.5	-141.0	-159.5	-152.5	-163.9	-168.6	-185.0	-175.8
Exports of G&S	806.7	817.9	816.1	862.9	879.4	896.4	901.0	923.3	932.8	954.0	961.3	987.0
Imports of G&S	910.7	932.6	953.5	961.3	1007.9	1037.4	1060.5	1075.8	1096.6	1122.5	1146.4	1162.9
Billions of dollars												
US CURRENT ACCOUNT BALANCE	-141.1	-162.4	-191.4	-166.2	-182.2	-181.5	-204.8	-211.7	-211.3	-218.4	-235.6	-236.8
Net Goods & Services (BOP)	-98.5	-115.8	-137.1	-106.1	-127.4	-123.9	-141.7	-135.0	-145.4	-147.1	-161.5	-149.4
Exports of G&S (BOP)	820.4	835.9	822.9	862.2	877.6	886.4	886.1	907.8	915.0	934.4	938.8	961.9
Imports of G&S (BOP)	918.9	951.7	960.0	968.2	1004.9	1010.4	1027.8	1042.8	1060.4	1081.6	1100.3	1111.3
Net Investment Income	1.2	-8.9	-16.4	-9.7	-15.8	-18.6	-24.0	-26.6	-26.9	-32.3	-35.1	-37.3
Direct, Net	66.3	59.5	58.9	73.0	69.5	69.6	67.7	68.9	72.2	70.6	72.4	74.6
Portfolio, Net	-65.1	-68.4	-75.3	-82.7	-85.3	-88.2	-91.8	-95.5	-99.1	-102.8	-107.5	-111.9
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.