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# Part 1

August 14, 1997

## CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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### Summary and Outlook

Strictly Confidential (FR) Class II FOMC

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August 14, 1997

## **SUMMARY AND OUTLOOK**

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

## Domestic Developments

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### Overview

The economy has continued to hum along in recent months, propelled by renewed growth in consumer spending and a strong uptrend in business outlays for new equipment. With incoming reports on corporate earnings providing more upside surprises than disappointments, the stock market rallied further during the intermeeting period. The favorable financial environment and a general mood of optimism among households and businesses bode well for sustained solid growth in domestic final demand. However, growth of activity seems likely to be damped considerably in the near term by a slowing of inventory accumulation from the unsustainably brisk pace of the first half of the year. Accordingly, we are predicting that real GDP will increase just 2-1/4 percent, at an annual rate, over the second half. This is roughly 1/2 percentage point slower than in the last Greenbook--the true difference being exaggerated by the switch in aggregation method to chain weighting, which is subtracting around 1/4 percentage point from GDP growth rates on average throughout the projection period.

Our forecast for economic activity in 1998 is little changed. We continue to look for an increase in real GDP of about 2 percent, on a fourth quarter to fourth quarter basis. The recent upside surprise in the stock market suggests an added boost to private demand next year, through wealth and cost-of-capital effects, but the further appreciation of the dollar on exchange markets since early July is likely to result in a greater weakness in net exports than we previously anticipated.

We have reassessed our assumptions regarding the prospective growth rate of potential output in light of the new NIPA data; we have concluded that we should put the underlying cyclically adjusted trend for real GDP at 2.1 percent per annum. As a result, our GDP forecast implies little change in the unemployment rate from the 4.8 percent reported in July. While it is unlikely that there will be any broad strains on physical capacity in the industrial sector, the tightness of the labor market probably will show through gradually in wages and prices. That said, we have once again trimmed our forecast of core CPI inflation to 2-1/2 percent in 1997 and 2-3/4 percent in 1998, partly because of expected greater weakness of non-oil import prices and a slightly lower level of resource utilization.

### Key Background Factors

We have retained our previous assumption that the federal funds rate will be held at 5-1/2 percent until well into next year and then raised somewhat to prevent a slippage in real short rates as inflation rises. Given the normal lags in the response of

aggregate demand, this modest shift in money market conditions would be unlikely to have much effect on the economy during 1998. However, it seems probable that some tightening will be necessary, at least for a time, to avert an ongoing deterioration in the trend of inflation in 1999 and beyond.

The bond market recently took a run at its previous cyclical lows for yields, and despite a backup in the past couple of weeks, long-term rates remain below the levels built into our previous forecast. And because we are projecting a somewhat more benign growth and inflation environment going forward, we have lowered our predicted path for nominal bond yields. Nonetheless, we still expect that long-term rates will trend upward gradually as the perception of increasing cost pressures enhances concerns about the possibility of Fed tightening--concerns that, as noted, we assume will ultimately be validated by the System's actions.

We expect that share prices will show no sustained upward movement from here and will decline substantially in 1998. The anticipated upward movement in interest rates should tend to erode equity values. Also important, though, is our expectation that a flattening of corporate profits will in time undermine the view that the S&P 500 can continue to record double-digit earnings gains even in a moderate-growth, low-inflation economy. The weakening of profitability will likely have adverse effects on corporate cash flow and credit quality. Risk premia in debt markets, which have been extraordinarily narrow of late, probably will widen.

Our fiscal policy assumptions have been little changed by the enactment of the budget agreement. We see negligible fiscal restraint on aggregate demand over the forecast period. The unified budget deficit for fiscal 1997 probably will come in \$23 billion below our previous projection, at about \$36 billion: Tax revenues have continued to run on the high side of our expectations, and net outlays have been held down by, among other things, extra receipts from sales of radio spectrum rights. Even with some timing gimmicks in the budget deal that shift tax revenues into fiscal 1999, we have lowered the projected deficit to \$62 billion in the coming fiscal year, compared with \$85 billion in the last Greenbook.

In the external sector, the main change relates to the foreign exchange value of the dollar. As measured by its trade-weighted value against other G-10 currencies, the dollar is again projected to depreciate modestly over the forecast period, but starting from a level that is slightly more than 4 percent higher than in the June Greenbook. With regard to real activity abroad, the outlook for aggregate foreign real GDP growth remains close to 4 percent at an annual rate this year and next. And we continue to

expect that crude oil prices will fall a bit further by year-end and then rebound by \$1 per barrel over the course of 1998--to \$19.50 for spot WTI.

### **Recent Developments and Outlook for the Current Quarter**

We estimate that real GDP grew 2-1/2 percent (annual rate) last quarter, a bit above the June Greenbook and BEA's advance report.<sup>1</sup> At this juncture, a major uncertainty about the second-quarter arithmetic is the pace of stockbuilding. A literal translation of the June reports on manufacturing and trade stocks would point to a substantial upward revision to BEA's already hefty advance estimate. Moreover, BEA's estimate of inventory investment outside of manufacturing and trade--constructed from a hodge-podge of direct and indirect evidence--looks especially high by historical standards. We find no support for such rapid accumulation in anecdotal reports or other indicators. One way or another, we expect that BEA will publish a number for second-quarter stockbuilding that is significantly lower than the data currently in hand suggest--though not necessarily in the next ("preliminary") estimate of second-quarter GDP. Even with this adjustment, however, our assumed second-quarter rate of inventory accumulation remains well above the pace consistent with moderate growth in sales, and, thus, we expect the pace of stockbuilding to diminish in the current quarter and thereby restrain real growth substantially. As a result, we are predicting that real GDP will advance at an annual rate of 2.2 percent in the current quarter, despite an acceleration in final sales.

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1. Comparisons between estimates of real GDP growth in the current and previous Greenbooks need to correct for BEA's switch in July from using a Laspeyres index to aggregate real quantities in recent quarters to a quarterly chain approach. We have modified our forecasting procedures to keep them in sync with BEA's approach. The change in method reduces both recent historical estimates and our 1997 forecasts of real GDP growth about 0.1 percentage point at an annual rate, all else equal, so that, in the absence of this change, our current estimate of real GDP growth for the second quarter would be 1/2 percentage point higher than in the last Greenbook. The effects of the aggregation revision increase going forward, and we expect the change in aggregation will shave reported growth of real GDP by 0.3 percentage point in 1998. For those components of real GDP with large shares of computers and other high-tech goods--equipment investment, exports, and imports--the change in aggregation induces relatively large downward adjustments to their growth rates in this Greenbook compared with the June and earlier Greenbooks. Downward adjustments are relatively small for components with small computer shares.

On the assumption that the UPS strike will end in the not-too-distant future, we have not anticipated a significant GDP growth effect this quarter. The disruption to shipping is no doubt causing some problems in the production and distribution chain, but the available--admittedly very fragmentary--anecdotal evidence suggests that aggregate effects have been small. Furthermore, a portion of the sales that have been lost to date are likely to be made up quickly.

The strike certainly will leave some imprint on the payroll measures for August, given that this is the reference week for the monthly survey. To this point, however, the labor market indicators would appear consistent with at least moderate growth of activity. The increase in private payrolls in July, at 260,000, was very strong, but aggregate production worker hours were weak. The implied decline in the average workweek seems doubtful, and we are anticipating a considerable snapback in total hours in the ensuing months (perhaps September, rather than August, given the UPS strike). The low level of initial claims in recent weeks certainly suggests a vibrant demand for workers, as do a variety of other market indicators.

We expect that growth of final sales will pick up to a pace of 3-1/2 percent this quarter, lifted by a rebound in personal consumption expenditures. On the heels

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

Measure	1997:Q2			1997:Q3	
	June GB	BEA <sup>a</sup>	Aug. GB	June GB	Aug. GB
<b>Real GDP</b>	2.2	2.2	2.6	2.9	2.2
Private domestic final purchases	3.0	2.7	2.8	4.7	5.0
Personal consumption expenditures	1.4	.8	.8	4.0	4.2
Residential investment	4.4	5.6	7.5	-2.5	-5.0
Business fixed investment	13.0	15.1	15.3	11.3	14.6
Government outlays for consumption and investment	3.1	3.8	3.7	-.3	-.5
	Change in billions of chained (1992) dollars				
Inventory investment	-5.6	3.1	7.2	.3	-24.9
Net exports	-11.9	-21.6	-17.9	-17.2	-9.2

a Advance.

of an anemic increase of 0.8 percent at an annual rate in the second quarter, real consumer expenditures are forecast to grow at a 4-1/4 percent annual rate this quarter. The turnaround in durables appears likely to be particularly strong with consumer purchases of new vehicles having posted a sizable improvement in July. The "control" component of nominal retail sales (which excludes automotive dealers and building material and supply stores) increased 0.4 percent in June and 0.5 percent in July-- numbers that imply appreciable real gains, given the low rate of goods inflation. We expect consumption growth to hold up well over the remainder of the quarter in light of the past year's enormous stock market gains and the prevailing high levels of consumer sentiment indexes.

Another double-digit advance in outlays for producers' durable equipment appears in store for this quarter. Demand for computers reportedly remains robust and is likely to be buoyed by recently announced price cuts on PC microprocessors. Aside from computers, growth in communications equipment and motor vehicles is expected to pick up, domestic aircraft deliveries should advance strongly, and, with shipments having spurred in June to well above the average level of the second quarter, we expect a further strong increase in other PDE.

Net exports and residential investment are expected to be on the weak side this quarter. Apart from the ongoing effects of the appreciation of the dollar since the turn of the year, residual seasonality in the NIPA measure should contribute to a decline in net exports. Although housing demand appears buoyant, the decline in the average level of starts in the second quarter should translate mechanically into a contraction in residential construction expenditures in the current quarter.

The projected growth of activity should be sufficient to keep the pressure on labor supplies. Wages--measured through July in the case of average hourly earnings-- have given no statistical sign of accelerating; however, in September, labor costs will receive a jolt from the hike in the minimum wage. The latest price data have maintained prior favorable trends, and the CPI is expected to rise at a 2-1/4 percent rate this quarter--up from the low pace of the second quarter and about the same increase as recorded over the past year. As suggested by the flattening in the energy component of the CPI in the last two months, the benefit of this year's oil price drop is now largely behind us, and we foresee appreciable increases in energy prices over the remainder of the quarter. Food prices also appear to be accelerating somewhat this quarter. Excluding food and energy, CPI prices are projected to rise at a 2-1/4 percent annual rate.

### **The Longer-Run Outlook**

As indicated in the overview, we have reduced our forecast of real GDP growth over the second half of this year noticeably in response to the surprisingly high rate of inventory accumulation through the second quarter. That buildup came on the heels of several quarters that, in the revised NIPA, now show a less favorable trend in aggregate inventory-sales ratios. It is impossible to gauge with any confidence the timing and dimension of movements in this volatile sector, but we now expect that a downshift in inventory accumulation will directly reduce real GDP growth by roughly a percentage point in the second half. The predicted growth of real final sales has been revised up a bit to 3-1/2 percent.

Anticipating that inventory investment will have been brought to a sustainable pace by the end of this year, we expect that inventory accumulation will be a neutral factor in GDP growth next year. As noted in the overview, revisions to the outlook for final sales incorporate not only some added restraint coming from the higher exchange value of the dollar, but also a modest positive increment coming from a higher level of stock prices. On net, we expect that real final sales (like real GDP) will advance about 2 percent. As before, the moderation next year in the growth of aggregate demand is rooted in the less favorable financial conditions anticipated for 1998 and in our view that rates of accumulation of physical capital in the household and business sectors are already high. Given the tightness of labor markets, supply constraints will also tend to limit the degree to which output can be expanded, with the tension visible in gradually rising inflation.

**Consumer spending.** Our forecast of consumption growth is marginally stronger than last time, but the basic contour is unchanged: a strong rebound in the third quarter from a weak second quarter and then a slowing through the remainder of this year and in 1998.

The projected slowing in consumption growth, to a pace of about 2-1/2 percent in 1998, owes mainly to a projected slackening of employment and income growth. Although we continue to expect a reversal of fortunes in the stock market next year, it is likely that the bulk of the direct effect of a retrenchment in equity prices would not be felt until late in the year or in 1999, given the usual lags in the response of consumption to changes in wealth. However, consumer sentiment could become a less favorable factor much sooner, for it currently seems to be on the high side of what might normally be expected on the basis of such macro variables as the rates of unemployment and inflation, current or prospective.

As discussed in an appendix in Part 2, the NIPA revisions have resulted in a downward drift in the saving rate that is far more consistent with its historical relation to wealth. In prior Greenbooks, we noted our surprise at the reported rise in the saving rate in the face of a soaring wealth-to-income ratio. The persistence of this pattern in the previous data had led us to speculate that several factors could be limiting or offsetting the wealth effect. We noted that households might have raised their savings accumulation targets in light of perceived greater retirement needs. We also conjectured that responses to those wealth gains accruing in tax-preferred retirement accounts might be especially muted or that the astonishing sharpness of the stock price run-up might be causing investors to be cautious in marking up their permanent incomes. While these stories retain some appeal, the saving rate revisions argue for giving them less weight. Our forecast of the saving rate is now considerably lower

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

Measure	1997:H1	1997:H2	1998
<b>Real GDP</b>	<b>3.7</b>	<b>2.3</b>	<b>2.0</b>
Previous	4.0	2.9	2.1
Final sales	2.5	3.3	2.0
Previous	3.2	3.2	2.1
PCE	3.0	3.7	2.6
Previous	3.5	3.6	2.5
Residential investment	5.4	-1.6	-3.6
Previous	5.1	-1.6	-2.0
BFI	9.6	9.3	5.9
Previous	11.6	9.2	6.3
Government purchases	1.6	.6	.7
Previous	1.6	1.1	.8
	Change, billions of chained (1992) dollars		
Inventory change	37.9	-40.6	-6
Previous	24.4	-12.6	2.5
Net exports	-38.6	-5.6	-37.5
Previous	-33.9	-12.0	-23.8

than before, and the saving rate now declines year-by-year from 1996 to 1998, in contrast to its virtual stability in the last Greenbook. Importantly, we now perceive the risks surrounding this projection to be better balanced than before, when we were concerned that the wealth effect, rather than being offset, might simply have been delayed--leaving open the possibility of a major surge in demand at any time.

**Residential investment.** Housing activity has continued to show substantial strength, with demand for single family homes reflecting brisk income and employment growth, mortgage rates that are now below those posted over most of 1996, and the increases in stock market wealth. Indeed, affordability considerations might suggest that demand for single-family houses could rise appreciably from here--and we certainly would not rule out that possibility. But our sense is that the pace of construction has been running for a while above the longer-term trends of housing demand associated with demographics, scrappage, and the like. Thus, although we are projecting a bounceback from the second-quarter dip in starts, the projected total for single-family starts in 1997, 1.13 million units, is a bit short of the 1.16 million units in 1996. Moving into 1998, we continue to expect a further moderation in single-family starts, to a pace of 1.11 million units, in response to a rise in mortgage rates and a slowing of income and employment growth.

Multifamily starts, too, should edge down next year with the projected rise in interest rates. Shipments of manufactured housing, now averaging about 20 percent of the supply of new housing units, are expected to be little changed from 1996 levels over the course of 1997 but to decline slightly next year.

We do not expect the more advantageous tax treatment of housing capital gains that is part of the budget act to have much effect on housing construction this year or next. Although the unlocking of some existing capital gains may give the market more fluidity, in fact most capital gains on owner-occupied dwellings have in the past eluded taxation. In addition, if low inflation is expected to persist, capital gains taxes on housing are less of an issue anyway.

**Business fixed investment.** Real BFI has been, and likely will continue to be, the stellar sector of demand, with huge real growth in computer outlays leading the way. We have, in fact, revised up our projection of real growth in computer investment over both 1997 and 1998 to 30 percent per year. The NIPA revisions indicate that BEA is now capturing more fully the quality improvements in its deflation of computer sales--and, apart from this statistical consideration, we also have come to the view that the pace of technological innovation will override any broad, negative cyclical influence on investment that is in prospect. Spending on

communications equipment should also continue to rise rapidly: Demand for wireless phone services and Internet connections will remain robust; in addition, the Telecommunications Deregulation Act likely has boosted investment in switching and transmission equipment in anticipation of the demise of local phone monopolies, and we anticipate that such spending growth will continue unabated during 1998.

For other categories of equipment, we expect overall investment to decelerate from its second-quarter pace but still to show very healthy growth over the remainder of 1997. Orders trends look good, and many companies are flush with cash. In time, however, the projected upturn in the cost of capital, and the slowing growth of sales and corporate cash flow, should further temper non-high tech investment spending. All told, we are looking for PDE growth of about 12 percent over the second half of 1997 and about 7 percent over 1998.<sup>2</sup>

We have lowered our projection for growth in nonresidential structures investment, influenced to a degree by recently published revisions to construction data. Taken at face value, the new figures show that NRS has flattened out this year, a pattern fairly consistent with the data on construction contracts. Contracts for industrial, commercial, and institutional buildings have either flattened out or appear to be trending slightly downward from their recent highs, tendencies that were less pronounced at the time of the last Greenbook. That said, we are inclined to think that NRS will show some signs of life over the next year and a half. Statistics on vacancy rates and rents, along with anecdotal reports of market conditions and planned projects in a variety of locales, paint a rather upbeat picture of the prospects for at least some sectors of construction. Moreover, equity and debt capital are readily available to finance building. We are forecasting that growth in NRS investment will average about 3 percent during the latter half of this year and during 1998--with notable strength in the office and lodging sectors.

We might note that all of the growth we are projecting for BFI next year is expected to occur outside the manufacturing sector. The current high level of investment in manufacturing should boost capacity more than 4 percent this year. We expect that the level of investment in that sector will decline next year--slowing capacity growth to about 3 percent--as firms attempt to avoid building up their plant

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2. Although this PDE forecast is numerically similar to our previous projection, the current forecast is substantially stronger on a comparable aggregation basis. The effects of the upward revision to the computer forecast have been masked by the switch to chain weighting from Laspeyres aggregation. In the current Greenbook, this methodological change deducts about 1-1/4 percentage points this year and 3 percentage points next year from aggregate PDE growth.

and equipment at uneconomic rates. This might seem to be anticipating an extraordinary degree of forward-looking behavior relative to past cyclical patterns; it does appear, however, that firms in a number of industries are conscious of the risks of excessive capacity being built up domestically or internationally, and the focus on maximizing returns on equity among corporate management (and the security analysts that follow them) may temper the inclination to pour the marginal dollar of internal funds into extra investment.

**Inventory investment.** As mentioned above, even in our interpretation of the data, nonfarm stockbuilding in the first and second quarters--on the order of 5-3/4 percent at an annual rate--was high relative to a sustainable pace of sales growth. Moreover, supply conditions do not seem to point to any reason for firms to greatly elevate their target stock-sales ratios. Thus, we expect that firms will want to reduce their pace of inventory accumulation over the second half of 1997. Given the thrust of final demand, the adjustment should be accommodated without much disruption of the overall economy. Non-oil imports, which surged in the first half, will absorb some of the adjustment. Looking to 1998, we are expecting stock-sales ratios to be about flat, at levels somewhat above those that were recorded in early 1996, when the unexpected strength of final demand apparently led to some depletion of stocks.

**Government spending.** Real federal expenditures for government consumption and gross investment are expected to decline 1 percent over 1997, a slightly greater rate of decline than noted in the last Greenbook, reflecting a sharper retrenchment in defense spending than last projected. For 1998, our forecast is unchanged with real federal purchases projected to decline 2 percent; nondefense spending should be almost flat, while defense spending should fall 3-1/2 percent. The recent budget legislation did not materially alter the outlook for federal purchases.

Real purchases by state and local governments are likely to remain on a moderate growth path. The financial health of this sector has continued to improve with the unexpectedly strong revenue gains, but most jurisdictions do not appear to be inclined to open the spending spigots. The uncertainty regarding the consequences of the devolution of welfare and other social programs seems to be injecting an added element of caution into the political equation confronting public officials.

**Net exports.** With the further appreciation of the dollar on exchange markets, exporters and firms contending with imports will face tougher competition. The lagged effects of the appreciation will build over the projection period. Quarterly noise, some of it related to residual seasonality, tends to obscure the basic trends, but real net exports of goods and services are likely to subtract on the order of 1/2 percentage point

a year from GDP growth in 1997 and 1998. (A fuller discussion of the prospects for the external sector is contained in the *International Developments* section.)

**Labor Markets.** We had previously been assuming that trend labor productivity in the nonfarm business sector was rising 0.9 percent per year from 1990 to date—a figure higher than justified by the then-published data, but one that we thought might better reconcile various economic phenomena and be confirmed in the NIPA revision. In the event, the upward revision to output per hour was less than we anticipated. This presented us with a difficult analytical question, to which we are supplying a complicated answer. We have decided to assume that the cyclically adjusted trend from 1990 to 1995 was only 0.8 percent, but that it has picked up to 1.0 percent since then. The new data do still show some acceleration of output per hour in the recent period. It is possible that this simply reflects the typical lagged adjustment of hours to a pickup in output growth, but we think it is appropriate to put a more optimistic interpretation on the step-up in productivity improvement. The underlying trend may have steepened a little as a consequence of the capital deepening that has occurred with robust investment and of a possibly more effective use of information technology. It is this reasoning that has led us to raise our estimate of the current trend growth of potential GDP to just over 2 percent.

We expect that actual productivity increases will be a little short of the trend over the remainder of this year and next, because the remaining pool of unemployed labor is less skilled on average than was the case earlier in the expansion. Apart from

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

Measure	1995	1996	1997	1998
Output per hour, nonfarm business	.4	1.2	1.0	.8
Previous	-.1	.9	1.5	.8
Nonfarm payroll	2.0	2.1	2.2	1.4
Previous	2.0	2.1	2.1	1.6
Household employment survey	.6	2.1	2.2	1.3
Previous	.6	2.1	2.3	1.4
Labor force participation rate <sup>1</sup>	66.5	66.9	67.2	67.3
Previous	66.5	66.9	67.3	67.4
Civilian unemployment rate <sup>1</sup>	5.6	5.3	4.7	4.7
Previous	5.6	5.3	4.7	4.6

1. Percent, average for the fourth quarter.

the influx of welfare recipients into the workforce, reports seem to have proliferated of difficulties in finding qualified workers and of greater time spent in remedial training.

Monthly payroll increases are expected to slow to about 190,000 per month over the remainder of 1997 and about 145,000 per month in 1998. Downward pressures on the unemployment rate are tempered by a rise in the labor force participation rate. We expect the rate to reattain its recent high in response to the ready availability of jobs.

**Wages and prices.** Our forecasts of price inflation and the rate of increase of hourly compensation costs have been revised downward. Data received since the last Greenbook in both areas have been a hair more favorable than expected, and the slight upward revision to the unemployment projection lessens marginally the prospective tightness of labor markets.

All that said, we continue to view current and projected levels of the unemployment rate as being unsustainably low, and we anticipate a gradual acceleration of both hourly compensation and prices next year. The rate of increase of ECI compensation per hour is projected to pick up from 2.9 percent over the year ended this June to 3.3 percent over the course of 1998. Most of this acceleration is expected to occur in the near term, with the second increase in the federal minimum giving aggregate wages an extra boost. Benefit costs appear to be firming now, with medical insurance premiums increasing; however, we expect that the step-up in benefit inflation over the coming quarters will not greatly exceed that of wages.

On the face of it, the projected rise in compensation inflation is modest relative to what might be expected in light of the tightness of the labor market. To some extent, this reflects the influence of favorable price movements--largely related to developments in the food and energy sectors and the foreign exchange value of the dollar--which are helping to translate nominal wage increases into larger real gains. Indeed, measured in product price terms, our ECI forecast implies that real compensation will be rising appreciably faster than productivity, thereby reversing the downdrift in labor's share of national income now more strikingly revealed in the NIPA for recent years. It is possible that measured compensation acceleration could be damped as well by a spreading use of devices such as stock options and signing bonuses that are not picked up in the ECI. And the actual acceleration might be tempered by the more flexible pay structures that permit firms to pinpoint wage increases to employees with scarce skills. But counterbalancing those considerations is the possibility that the insecurity of workers is starting to wane. Some have pointed to

the strikes at GM and UPS as straws in the wind in this regard, but we believe that the significance of these events could be easily overstated.

On the price side, we are projecting an increase in core CPI inflation from 2.4 percent over the year ended July to 2.8 percent over the four quarters of 1998.<sup>3</sup> In part, this increase reflects the expected pressure from accelerating unit labor costs. But some additional impetus to inflation comes from the projected swing in the dollar from appreciation to depreciation, which is reflected in an expected slowing of the rate of decline of non-oil import prices. On the other hand, a 3/4 percentage point decline in

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

Measure	1995	1996	1997	1998
Consumer price index	2.6	3.2	2.1	2.6
Previous	2.6	3.2	2.2	2.8
Food	2.6	4.2	1.5	2.4
Previous	2.6	4.2	1.7	2.6
Energy	-1.6	7.6	-1.6	1.0
Previous	-1.6	7.6	-2.6	1.8
Excluding food and energy	3.0	2.6	2.5	2.8
Previous	3.0	2.6	2.7	3.0
PCE chain-weighted price index	2.2	2.7	1.8	2.4
Previous	2.1	2.5	2.1	2.6
Excluding food and energy	2.4	2.3	2.0	2.5
Previous	2.3	2.0	2.4	2.7
GDP chain-weighted price index	2.4	2.3	2.0	2.3
Previous	2.5	2.1	2.2	2.5
ECI for compensation of private industry workers <sup>1</sup>	2.6	3.1	3.2	3.3
Previous	2.6	3.1	3.3	3.4
Prices of non-oil merchandise imports	-6	-5.9	-3.0	-1.2
Previous	.8	-2.9	-.5	.7

1. December to December.

3. The acceleration of CPI prices (core and total) in 1998 is tempered 0.1 percentage point by an update of the market basket next year. Starting from 1995, the cumulative effect of technical changes in the index will reduce CPI inflation 0.4 percentage point in 1998.

manufacturing capacity utilization from where it is now should help damp price pressures, and the relative prices of food and energy are expected to decline further. Reports so far indicate that this fall's crop harvest is likely to be large enough to permit some rebuilding of stocks, and we have further reduced our projection of CPI food price inflation 1/4 percentage point, to 1-1/2 percent this year and 2-1/2 percent next year. For energy prices, a qualitatively similar picture is expected in which such prices damp overall inflation, but to a lesser degree in 1998 than in 1997. (Electricity prices should be restrained somewhat by steps being taken to deregulate utilities in a number of states.) All told, the overall CPI is projected to increase 2.1 percent this year and 2.6 percent next year.

### **Monetary and Credit Flows**

Total debt of the domestic nonfinancial sector is projected to rise 4-3/4 percent this year and next. Reflecting the widening of the federal budget deficit, growth in federal sector debt picks up from 1-1/4 percent in 1997 to 2-1/2 percent in 1998--still well below the increase recorded in all but two years since 1970. Growth in state and local government debt also is expected to move higher next year, largely because of the continued decline in retirements of bonds that were advance-refunded in earlier years.

Growth of total household debt is estimated to have slowed in the second quarter, and we project some further edging off, leaving growth at 6-1/2 percent this year and 5-3/4 percent in 1998. These increases still exceed the projected gains in nominal income and, combined with the anticipated uptrend in interest rates, imply a small rise in household debt service burdens. In this environment, delinquency rates are likely to stay elevated and could rise even a bit more. Lenders, who have already tightened supply at the margin for consumers, may take further steps to limit funds for weak borrowers. Nonetheless, we view these actions as likely to exert only modest restraint on overall credit supply. Rather, the slower growth of household debt in our projection mainly results from reduced credit demand as housing activity slows and outlays for durable goods grow at a more subdued pace after the current quarter.

In contrast, we expect the pace of business borrowing, which quickened in the first half of this year, to remain brisk over the forecast period. Even with the slowing of inventory accumulation, external financing needs should grow as profits weaken and spending on fixed capital continues to rise. Moreover, merger activity likely will remain robust, and the cash payments involved in these deals will continue to be funded, in part, by borrowing. The associated equity retirements, along with ongoing share repurchases, will keep net equity issuance in negative territory. Although the

best news about corporate credit quality likely is behind us, we foresee only a moderate deterioration in business balance sheets. Nonetheless, if stock prices retreat in 1998, as we expect, the cost of equity finance will rise, and the exceptionally narrow spreads now prevailing on junk debt could widen as investors become less complacent about risk-taking.

Over the rest of 1997 and the first half of 1998, growth of M2 is projected to remain close to that of nominal GDP. In the second half of 1998, the assumed increases in the federal funds rate boost velocity, causing M2 to decelerate. The growth of M3 is likely to remain above that of nominal GDP, as institutional money funds continue to attract corporate cash management accounts that previously had been invested directly in non-M3 instruments.

### 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 marginally--effects on the

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

Measure	1996	1997	1998
<i>Real GDP</i>			
Baseline	3.2	3.0	2.0
No further change	3.2	3.0	2.1
Tighter policy	3.2	3.0	1.3
<i>Civilian unemployment rate<sup>1</sup></i>			
Baseline	5.3	4.7	4.7
No further change	5.3	4.7	4.7
Tighter policy	5.3	4.7	5.0
<i>CPI excluding food and energy</i>			
Baseline	2.6	2.5	2.8
No further change	2.6	2.5	2.8
Tighter policy	2.6	2.5	2.6

1. Average for the fourth quarter.

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. The paths would begin to diverge noticeably in 1999, and, as we suggested above, the relevance of the assumed tightening in the Greenbook forecast is to the intensity of inflationary pressures beyond 1998.

The second alternative involves a more aggressive approach for capping inflation. The federal funds rate is raised gradually and is 125 basis points higher than the current rate by the second quarter of 1998. Growth of real GDP in 1998 is appreciably slower in this alternative, the unemployment rate ends up about 1/4 percentage point higher than it is in the baseline forecast, and acceleration of core inflation is forestalled in 1998. Given the pressures on labor resources that remain at the end of the period, however, a continuation of the high real rate of interest associated with this scenario might be necessary in 1999 to continue to hold inflation steady. One might question, however, whether--starting from today's optimistic valuations--the negative response of the stock market to the hypothesized string of tightening steps might not be larger than the norm captured by the model, with sharper macro responses as a consequence.

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Class II FOMC

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

August 14, 1997

Interval	Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index <sup>1</sup>		Unemployment rate <sup>2</sup>		
	06/25/97	08/14/97	06/25/97	08/14/97	06/25/97	08/14/97	06/25/97	08/14/97	06/25/97	08/14/97	
<b>ANNUAL</b>											
1994	5.8	5.9	3.5	3.5	2.3	2.4	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	4.4	5.1	2.4	2.8	2.1	2.3	3.0	3.0	5.4	5.4	
1997	5.5	5.5	3.7	3.4	2.2	2.1	2.4	2.4	4.9	5.0	
1998	4.5	4.3	2.4	2.2	2.4	2.2	2.6	2.4	4.6	4.7	
<b>QUARTERLY</b>											
1995	Q1	3.8	4.2	0.4	0.9	3.3	3.3	2.7	2.7	5.5	5.5
	Q2	3.1	2.3	0.7	0.3	2.4	2.1	3.5	3.5	5.6	5.6
	Q3	6.0	5.2	3.8	3.0	2.1	2.0	2.1	2.1	5.7	5.7
	Q4	2.3	4.5	0.3	2.2	2.1	2.1	2.6	2.6	5.6	5.6
1996	Q1	4.2	4.7	2.0	1.8	2.3	2.8	3.2	3.2	5.6	5.6
	Q2	6.5	7.7	4.7	6.0	2.2	1.9	3.4	3.4	5.4	5.4
	Q3	3.8	3.6	2.1	1.0	2.0	2.7	2.8	2.8	5.3	5.3
	Q4	5.3	6.2	3.8	4.3	1.9	1.9	3.3	3.3	5.3	5.3
1997	Q1	8.1	7.4	5.8	4.9	2.8	2.4	2.3	2.3	5.3	5.3
	Q2	3.9	4.2	2.2	2.6	1.9	1.5	1.1	1.0	4.9	4.9
	Q3	4.8	3.9	2.9	2.2	2.1	1.9	2.4	2.2	4.8	4.8
	Q4	4.7	4.5	2.8	2.4	2.2	2.1	2.8	2.6	4.7	4.7
1998	Q1	4.6	4.4	2.5	2.3	2.5	2.3	2.7	2.4	4.6	4.7
	Q2	4.5	4.4	2.3	2.1	2.5	2.3	2.8	2.5	4.6	4.7
	Q3	4.2	4.1	2.0	1.9	2.6	2.3	3.0	2.7	4.6	4.7
	Q4	4.0	4.0	1.8	1.7	2.6	2.4	2.9	2.7	4.6	4.7
<b>TWO-QUARTER<sup>3</sup></b>											
1995	Q2	3.5	3.2	0.6	0.6	2.9	2.7	3.0	3.0	0.0	0.0
	Q4	4.1	4.8	2.0	2.6	2.1	2.1	2.3	2.3	0.0	0.0
1996	Q2	5.4	6.2	3.3	3.8	2.2	2.3	3.4	3.4	-0.2	-0.2
	Q4	4.6	4.9	3.0	2.7	2.0	2.3	3.0	3.0	-0.1	-0.1
1997	Q2	6.0	5.8	4.0	3.7	2.3	2.0	1.8	1.7	-0.4	-0.4
	Q4	4.7	4.2	2.9	2.3	2.1	2.0	2.6	2.4	-0.2	-0.2
1998	Q2	4.5	4.4	2.4	2.2	2.5	2.3	2.7	2.5	-0.1	-0.0
	Q4	4.1	4.1	1.9	1.8	2.6	2.4	2.9	2.7	-0.0	-0.0
<b>FOUR-QUARTER<sup>4</sup></b>											
1994	Q4	5.9	5.8	3.5	3.3	2.3	2.5	2.7	2.7	-1.0	-1.0
1995	Q4	3.8	4.0	1.3	1.6	2.5	2.4	2.6	2.6	0.0	0.0
1996	Q4	5.0	5.6	3.1	3.2	2.1	2.3	3.2	3.2	-0.3	-0.3
1997	Q4	5.4	5.0	3.4	3.0	2.2	2.0	2.2	2.1	-0.6	-0.6
1998	Q4	4.3	4.2	2.1	2.0	2.5	2.3	2.8	2.6	-0.1	-0.1

1. For all urban consumers.

2. Level, except as noted.

3. Percent change from two quarters earlier; for unemployment rate, change in percentage points.

4. Percent change from four quarters earlier; for unemployment rate, change in percentage points.

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Class II FOMCREAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, ANNUAL VALUES  
(Seasonally adjusted annual rate)

August 14, 1997

Item	Units <sup>1</sup>	- Projected -								
		1990	1991	1992	1993	1994	1995	1996	1997	1998
<b>EXPENDITURES</b>										
Nominal GDP	Bill. \$	5743.8	5916.7	6244.4	6558.1	6947.0	7265.4	7636.0	8055.3	8398.9
Real GDP	Bill. Ch. \$	6136.3	6079.4	6244.4	6389.6	6610.7	6742.1	6928.4	7166.6	7324.4
Real GDP	% change	-0.2	0.4	3.6	2.4	3.3	1.6	3.2	3.0	2.0
Gross domestic purchases		-0.8	0.0	4.0	3.0	3.6	1.2	3.6	3.5	2.4
Final sales		0.6	-0.4	3.9	2.1	2.7	2.2	3.1	3.0	2.0
Priv. dom. final purchases		-0.7	-0.8	4.9	3.7	3.7	2.5	3.8	4.1	2.8
Personal cons. expenditures		0.5	-0.2	4.2	2.7	3.1	2.2	2.7	3.4	2.6
Durables		-3.2	-3.1	9.4	7.4	6.3	3.0	3.9	6.3	4.4
Nondurables		-0.5	-1.0	3.4	1.6	3.0	1.0	1.8	2.3	2.2
Services		2.0	0.9	3.6	2.3	2.5	2.7	2.8	3.3	2.4
Business fixed investment		-2.5	-6.0	5.5	9.9	7.6	6.5	11.7	9.5	5.9
Producers' dur. equipment		-2.0	-2.6	9.6	12.2	10.2	8.3	12.2	13.0	6.9
Nonres. structures		-3.5	-12.5	-3.4	4.5	1.1	2.0	10.3	0.6	3.1
Residential structures		-15.1	1.1	16.9	7.8	4.2	-1.9	3.9	1.9	-2.6
Exports		7.2	8.6	4.1	4.6	10.0	10.3	9.3	8.7	4.4
Imports		0.5	4.1	7.4	10.2	12.3	5.6	11.8	12.2	7.2
Gov't. cons. & investment		2.6	-0.7	1.7	-1.4	0.1	-1.4	2.0	1.1	0.7
Federal		1.6	-3.1	1.3	-6.1	-3.9	-6.0	1.5	-0.9	-2.1
Defense		0.3	-5.3	-1.3	-6.9	-6.0	-5.9	1.1	-2.7	-3.5
State & local		3.3	1.0	2.0	2.0	2.7	1.4	2.2	2.2	2.3
Change in bus. inventories	Bill. Ch. \$	10.4	-3.0	7.0	22.1	60.6	27.3	25.0	52.7	34.3
Nonfarm		7.8	-1.2	2.0	29.5	49.0	35.7	22.5	46.9	31.2
Net exports		-61.9	-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-143.4	-181.5
Nominal GDP	% change	4.4	3.8	6.3	5.0	5.8	4.0	5.6	5.0	4.2
<b>EMPLOYMENT AND PRODUCTION</b>										
Nonfarm payroll employment	Millions	109.4	108.3	108.6	110.7	114.1	117.2	119.5	122.2	124.3
Unemployment rate	%	5.6	6.8	7.5	6.9	6.1	5.6	5.4	5.0	4.7
Industrial prod. index	% change	-0.6	-0.0	3.9	3.0	5.7	1.8	3.9	3.8	1.8
Capacity util. rate - mfg.	%	81.4	78.0	79.5	80.8	83.1	83.1	82.1	82.3	81.6
Housing starts	Millions	1.19	1.01	1.20	1.29	1.46	1.35	1.48	1.45	1.42
Light motor vehicle sales		14.05	12.52	12.85	13.87	15.02	14.73	15.05	14.99	14.87
North Amer. produced		10.85	9.74	10.51	11.71	12.88	12.82	13.34	13.08	13.04
Other		3.20	2.77	2.34	2.15	2.13	1.90	1.71	1.90	1.83
<b>INCOME AND SAVING</b>										
Nominal GNP	Bill. \$	5764.9	5932.4	6255.5	6576.8	6955.2	7270.6	7637.7	8037.8	8369.6
Nominal GNP	% change	4.6	3.5	6.2	5.1	5.7	4.1	5.5	4.6	4.1
Nominal personal income		6.4	3.7	7.3	4.2	5.1	5.2	5.8	5.4	4.7
Real disposable income		1.1	0.8	4.0	1.5	2.4	2.4	2.0	2.9	2.5
Personal saving rate	%	5.3	6.0	6.2	5.1	4.2	4.8	4.3	3.7	3.5
Corp. profits, IVA & CCAdj.	% change	5.5	4.5	11.3	19.0	14.1	11.0	9.1	4.1	-0.9
Profit share of GNP	%	6.9	6.9	6.8	7.5	8.2	8.9	9.6	9.8	9.2
Excluding FR Banks	%	6.5	6.6	6.6	7.2	7.9	8.6	9.3	9.5	9.0
Federal surpl./deficit	Bill. \$	-154.7	-196.0	-280.9	-250.7	-186.7	-174.4	-110.5	-35.8	-35.2
State & local surpl./def.		80.1	75.8	86.3	87.4	96.8	103.1	105.3	102.5	105.3
Ex. social ins. funds		20.2	11.5	18.3	19.7	27.9	32.5	34.1	31.0	33.6
<b>PRICES AND COSTS</b>										
GDP implicit deflator	% change	4.7	3.4	2.6	2.6	2.5	2.4	2.2	1.9	2.2
GDP chn.-wt. price index		4.7	3.3	2.6	2.6	2.5	2.4	2.3	2.0	2.3
Gross Domestic Purchases										
chn.-wt. price index		5.2	2.7	2.7	2.3	2.5	2.3	2.3	1.6	2.3
CPI		6.3	3.0	3.1	2.7	2.7	2.6	3.2	2.1	2.6
Ex. food and energy		5.3	4.4	3.5	3.1	2.8	3.0	2.6	2.5	2.8
ECI, hourly compensation <sup>2</sup>		4.6	4.4	3.5	3.6	3.1	2.6	3.1	3.2	3.3
Nonfarm business sector										
Output per hour		-0.6	2.2	3.5	-0.2	-0.1	0.4	1.2	1.0	0.8
Compensation per Hour		5.8	4.8	4.5	1.8	1.9	2.8	3.3	3.6	3.6
Unit labor cost		6.4	2.5	1.0	2.0	2.0	2.4	2.1	2.5	2.8

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

Strictly Confidential <FR>  
Class II POMCREAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES  
(Seasonally adjusted, annual rate except as noted)

August 14, 1997

Item	Units	1994 Q1	1994 Q2	1994 Q3	1994 Q4	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2
<b>EXPENDITURES</b>											
Nominal GDP	Bill. \$	6794.3	6911.4	6986.5	7095.7	7168.9	7209.5	7301.3	7381.9	7467.5	7607.7
Real GDP	Bill. Ch. \$	6524.5	6600.3	6629.5	6688.6	6703.7	6708.8	6759.2	6796.5	6826.4	6926.0
Real GDP	% change	3.0	4.7	1.8	3.6	0.9	0.3	3.0	2.2	1.8	6.0
Gross domestic purchases		4.0	5.0	2.1	3.2	1.3	0.2	1.9	1.3	3.1	6.5
Final sales		1.2	3.4	3.3	2.7	1.8	1.9	3.3	2.0	2.6	5.2
Priv. dom. final purchases		3.7	4.4	2.7	3.8	2.5	2.2	2.8	2.5	4.4	5.5
Personal cons. expenditures		3.8	3.0	2.3	3.2	1.5	2.9	2.6	1.8	3.1	3.7
Durables		6.4	3.8	4.3	11.0	-3.0	3.9	9.3	2.0	4.8	9.7
Nondurables		5.0	2.1	2.2	2.7	1.7	0.9	0.7	0.7	1.7	2.6
Services		2.7	3.3	2.0	1.9	2.4	3.7	2.2	2.3	3.5	3.1
Business fixed investment		0.4	9.9	7.7	12.6	14.2	5.7	1.6	4.9	11.7	13.0
Producers' dur. equipment		7.0	5.9	11.4	16.9	16.1	6.2	2.0	9.4	13.1	14.9
Nonres. structures		-14.8	21.1	-1.1	2.3	9.5	4.3	0.7	-5.8	8.2	7.9
Residential structures		10.0	16.6	-3.1	-5.0	-7.0	-15.5	8.4	8.5	8.3	17.9
Exports		-1.8	17.7	10.6	14.7	7.2	9.3	13.5	11.5	1.7	9.6
Imports		7.6	19.0	13.1	9.9	10.0	7.7	2.3	2.4	13.1	14.1
Gov't. cons. & investment		-4.0	0.4	8.2	-3.8	0.6	-0.1	-0.7	-5.4	1.8	7.2
Federal		-10.7	-4.9	13.3	-11.3	-1.1	-4.5	-1.3	-16.4	7.5	8.8
Defense		-16.7	1.0	13.8	-18.6	-1.1	-1.6	-4.0	-15.9	6.1	11.0
State & local		0.7	4.0	5.1	1.2	1.7	2.6	-0.4	1.9	-1.4	6.3
Change in bus. inventories	Bill. Ch. \$	53.1	75.9	49.7	63.6	48.5	21.6	17.0	22.2	8.0	21.3
Nonfarm		39.6	59.6	38.2	58.7	54.7	34.0	29.6	24.4	14.5	17.3
Net exports		-97.6	-103.9	-111.1	-105.9	-113.5	-112.8	-92.9	-76.1	-100.8	-112.6
Nominal GDP	% change	5.5	7.1	4.4	6.4	4.2	2.3	5.2	4.5	4.7	7.7
<b>EMPLOYMENT AND PRODUCTION</b>											
Nonfarm payroll employment	Millions	112.6	113.7	114.7	115.6	116.5	116.9	117.4	117.9	118.5	119.2
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	5.5	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		14.95	14.91	14.89	15.31	14.67	14.42	14.86	14.96	15.04	15.13
North Amer. produced		12.84	12.76	12.69	13.24	12.66	12.46	13.00	13.18	13.38	13.43
Other		2.12	2.15	2.20	2.07	2.01	1.96	1.86	1.78	1.66	1.70
<b>INCOME AND SAVING</b>											
Nominal GNP	Bill. \$	6811.2	6920.3	6992.3	7096.8	7175.1	7220.6	7298.3	7388.5	7475.3	7610.5
Real GNP	% change	5.7	6.6	4.2	6.1	4.5	2.6	4.4	5.0	4.8	7.4
Nominal personal income		-3.0	11.1	5.1	7.6	7.4	4.1	4.3	5.1	6.8	6.6
Real disposable income		-4.7	6.7	2.9	4.9	4.5	0.2	2.6	2.5	3.5	1.1
Personal saving rate	%	3.4	4.2	4.4	4.7	5.3	4.6	4.5	4.6	4.7	4.1
Corp. profits, IVA & CCAdj.	% change	-19.9	45.2	21.6	20.1	-2.9	10.0	31.7	7.9	20.0	12.1
Profit share of GNP	%	7.5	8.1	8.4	8.7	8.5	8.7	9.2	9.3	9.6	9.7
Excluding FR Banks	%	7.3	7.9	8.2	8.4	8.2	8.4	8.9	9.0	9.3	9.4
Federal surpl./deficit	Bill. \$	-209.0	-163.2	-187.6	-186.8	-191.5	-179.5	-176.5	-150.2	-153.6	-111.6
State & local surpl./def.		84.7	94.8	98.4	109.3	107.7	105.6	101.1	97.8	104.1	114.4
Ex. social ins. funds		16.3	25.9	29.4	40.0	37.7	35.3	30.3	26.8	33.2	43.1
<b>PRICES AND COSTS</b>											
GDP implicit deflator	% change	2.4	2.2	2.6	2.7	3.3	2.0	2.1	2.2	2.9	1.7
GDP chn.-wt. price index		2.5	2.2	2.5	2.6	3.3	2.1	2.0	2.1	2.8	1.9
Gross Domestic Purchases											
chn.-wt. price index		2.0	2.6	3.0	2.5	3.0	2.5	1.7	1.9	2.7	1.8
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 <sup>1</sup>		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		-1.1	0.6	-1.1	1.3	-1.6	0.8	1.1	1.6	1.9	2.2
Compensation per hour		3.2	0.3	1.3	2.8	2.6	3.1	2.7	2.9	2.8	4.4
Unit labor cost		4.4	-0.2	2.4	1.6	4.2	2.3	1.6	1.3	0.9	2.1

1. Private-industry workers.

Strictly Confidential <FR>  
Class II FOMCREAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES  
(Seasonally adjusted, annual rate except as noted)

August 14, 1997

Item	Units	----- Projected -----									
		1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4
<b>EXPENDITURES</b>											
Nominal GDP	Bill. \$	7676.0	7792.9	7933.6	8014.9	8091.9	8180.7	8269.3	8357.8	8442.8	8525.8
Real GDP	Bill. Ch. \$	6943.8	7017.4	7101.6	7147.6	7187.0	7230.1	7270.7	7308.9	7343.2	7374.8
Real GDP	% change	1.0	4.3	4.9	2.6	2.2	2.4	2.3	2.1	1.9	1.7
Gross domestic purchases		2.4	2.5	5.9	3.3	2.6	2.2	3.1	2.4	2.8	1.3
Final sales		0.2	4.5	3.0	2.2	3.6	3.3	2.1	2.2	1.5	2.3
Priv. dom. final purchases		2.2	3.2	5.1	2.8	5.0	3.3	3.4	2.9	2.5	2.2
Personal cons. expenditures		0.5	3.3	5.3	0.8	4.2	3.3	3.1	2.8	2.4	2.1
Durables		-1.9	3.5	14.1	-5.6	13.0	5.0	5.7	4.8	3.9	3.4
Nondurables		0.6	2.1	4.7	-2.1	3.8	3.0	2.7	2.3	2.1	1.7
Services		1.0	3.9	3.9	3.7	2.8	3.1	2.9	2.6	2.3	2.0
Business fixed investment		16.5	5.9	4.1	15.3	14.6	4.3	6.4	6.1	5.7	5.3
Producers' dur. equipment		19.1	2.6	6.7	22.5	19.4	4.6	7.6	7.2	6.6	6.2
Nonres. structures		10.0	15.3	-2.1	-1.4	2.7	3.4	3.2	3.2	3.1	3.0
Residential structures		-4.5	-4.3	3.3	7.5	-5.0	1.9	-0.0	-2.5	-3.8	-3.9
Exports		1.9	25.5	9.9	14.0	2.3	8.9	2.2	7.1	0.5	8.2
Imports		13.2	6.8	17.9	19.9	5.4	6.3	8.4	8.9	7.5	3.9
Gov't. cons. & investment		-1.1	0.1	-0.4	3.7	-0.5	1.6	0.4	0.5	1.8	0.2
Federal		-4.2	-5.2	-5.8	8.4	-5.6	-0.1	-3.0	-2.7	0.9	-3.5
Defense		-4.6	-7.1	-11.8	10.3	-6.3	-1.5	-5.5	-4.7	0.6	-4.2
State & local		0.7	3.3	2.7	1.1	2.5	2.5	2.3	2.3	2.3	2.3
Change in bus. inventories	Bill. Ch. \$	37.9	32.9	63.7	70.8	45.9	30.2	34.2	33.1	40.4	29.6
Nonfarm		31.6	26.5	58.3	64.7	39.7	24.9	29.7	29.8	37.9	27.3
Net exports		-138.9	-105.6	-126.3	-144.2	-153.4	-149.8	-167.5	-175.4	-195.7	-187.3
Nominal GDP	% change	3.6	6.2	7.4	4.2	3.9	4.5	4.4	4.4	4.1	4.0
<b>EMPLOYMENT AND PRODUCTION</b>											
Nonfarm payroll employment	Millions	119.9	120.5	121.1	121.9	122.5	123.1	123.6	124.1	124.6	124.9
Unemployment rate	%	5.3	5.3	5.3	4.9	4.8	4.7	4.7	4.7	4.7	4.7
Industrial prod. index	% change	3.3	4.5	4.4	3.7	4.3	2.7	2.1	2.0	1.7	1.7
Capacity util. rate - mfg.	%	82.3	82.3	82.5	82.4	82.3	82.0	81.9	81.7	81.5	81.3
Housing starts	Millions	1.49	1.42	1.47	1.44	1.44	1.44	1.44	1.42	1.41	1.39
Light motor vehicle sales		15.08	14.95	15.26	14.51	15.13	15.05	15.01	14.95	14.82	14.68
North Amer. produced		13.38	13.18	13.34	12.67	13.16	13.17	13.15	13.11	13.01	12.89
Other		1.70	1.76	1.92	1.85	1.97	1.88	1.86	1.84	1.81	1.79
<b>INCOME AND SAVING</b>											
Nominal GNP	Bill. \$	7669.1	7796.1	7919.2	8000.6	8073.1	8158.3	8242.5	8329.6	8411.8	8494.6
Nominal GNP	% change	3.1	6.8	6.5	4.2	3.7	4.3	4.2	4.3	4.0	4.0
Nominal personal income		5.1	4.8	8.0	4.1	4.6	5.0	5.8	4.0	4.7	4.4
Real disposable income		2.7	0.7	4.6	2.1	2.5	2.3	5.0	1.3	1.9	1.8
Personal saving rate	%	4.5	3.9	3.7	4.0	3.6	3.4	3.9	3.5	3.4	3.4
Corp. profits, IVA & CCAdj.	% change	0.6	4.5	18.1	8.8	-6.0	-2.8	-2.4	-1.1	-0.3	0.2
Profit share of GNP	%	9.6	9.6	9.8	10.0	9.7	9.5	9.4	9.3	9.2	9.1
Excluding FR Banks	%	9.4	9.3	9.6	9.7	9.4	9.3	9.1	9.0	8.9	8.8
Federal surpl./deficit	Bill. \$	-99.5	-77.1	-55.5	-38.7	-21.3	-27.8	-41.6	-34.3	-30.6	-34.3
State & local surpl./def.		102.6	100.4	104.7	97.2	102.9	105.2	105.1	105.9	106.1	104.0
Ex. social ins. funds		31.1	28.9	33.5	25.6	31.3	33.6	33.5	34.2	34.4	32.3
<b>PRICES AND COSTS</b>											
GDP implicit deflator	% change	2.6	1.9	2.4	1.5	1.6	2.0	2.1	2.2	2.2	2.2
GDP chn.-wt. price index		2.7	1.9	2.4	1.5	1.9	2.1	2.3	2.3	2.3	2.4
Gross Domestic Purchases		2.4	2.4	1.9	0.8	1.6	2.1	2.3	2.2	2.3	2.3
chn.-wt. price index		2.8	3.3	2.3	1.0	2.2	2.6	2.4	2.5	2.7	2.7
CPI		2.4	2.7	2.2	2.9	2.2	2.8	2.7	2.7	2.8	2.8
Ex. food and energy											
ECI, hourly compensation <sup>1</sup>		2.8	2.8	2.5	3.4	3.3	3.5	2.8	3.5	3.6	3.5
Nonfarm business sector											
Output per hour		-1.0	1.8	1.4	1.1	1.0	0.4	1.0	0.8	0.6	0.8
Compensation per hour		2.9	3.3	4.5	3.1	3.2	3.5	3.6	3.6	3.6	3.6
Unit labor cost		3.9	1.5	3.1	1.9	2.2	3.0	2.6	2.8	3.0	2.8

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

August 14, 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	4.3	4.9	2.6	2.2	2.4	2.3	2.1	1.9	1.7	3.2	3.0	2.0
Gross dom. purchases	2.5	6.0	3.4	2.7	2.2	3.1	2.5	2.8	1.3	3.6	3.5	2.4
Final sales	4.5	3.0	2.2	3.6	3.3	2.0	2.2	1.5	2.3	3.1	3.0	2.0
Priv. dom. final purchases	2.7	4.2	2.4	4.1	2.8	2.8	2.4	2.1	1.9	3.1	3.4	2.3
Personal cons. expenditures	2.2	3.6	0.5	2.8	2.2	2.1	1.9	1.6	1.4	1.8	2.3	1.8
Durables	0.3	1.1	-0.5	1.1	0.4	0.5	0.4	0.4	0.3	0.3	0.6	0.4
Nondurables	0.4	0.9	-0.4	0.8	0.6	0.5	0.5	0.4	0.4	0.4	0.5	0.5
Services	1.5	1.5	1.4	1.1	1.2	1.1	1.0	0.9	0.8	1.1	1.3	0.9
Business fixed investment	0.6	0.4	1.7	1.6	0.5	0.8	0.7	0.7	0.7	1.2	1.1	0.7
Producers' dur. equip.	0.2	0.5	1.8	1.7	0.4	0.7	0.7	0.6	0.6	1.0	1.1	0.7
Nonres. structures	0.4	-0.1	-0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.0	0.1
Residential structures	-0.2	0.1	0.3	-0.2	0.1	-0.0	-0.1	-0.1	-0.1	0.2	0.1	-0.1
Net exports	1.8	-1.0	-1.0	-0.5	0.2	-1.0	-0.4	-1.1	0.5	-0.4	-0.6	-0.5
Exports	2.7	1.1	1.7	0.3	1.2	0.3	0.9	0.1	1.1	1.1	1.1	0.6
Imports	-0.8	-2.1	-2.8	-0.8	-1.0	-1.3	-1.4	-1.2	-0.6	-1.6	-1.7	-1.1
Government cons. & invest.	0.0	-0.1	0.7	-0.1	0.3	0.1	0.1	0.3	0.0	0.4	0.2	0.1
Federal	-0.4	-0.4	0.5	-0.4	-0.0	-0.2	-0.2	0.1	-0.2	0.1	-0.1	-0.1
Defense	-0.3	-0.6	0.4	-0.3	-0.1	-0.2	-0.2	0.0	-0.2	0.0	-0.1	-0.1
Nondefense	0.0	0.2	0.1	-0.1	0.1	0.0	0.0	0.0	-0.0	0.1	0.1	0.0
State and local	0.4	0.3	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Change in bus. inventories	-0.2	1.8	0.4	-1.4	-0.9	0.2	-0.1	0.4	-0.6	0.2	-0.0	-0.0
Nonfarm	-0.3	1.8	0.4	-1.4	-0.8	0.3	0.0	0.4	-0.6	0.0	-0.0	0.0
Farm	-0.0	-0.1	0.0	0.0	-0.0	-0.0	-0.1	-0.0	-0.0	0.1	-0.0	-0.0
GDP residual	-0.1	-0.2	-0.5	-0.5	-0.7	-0.8	-0.8	-0.9	-1.0	-0.5	-0.5	-0.9

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

Item	Fiscal year <sup>5</sup>				1996				1997				1998			
	1995 <sup>a</sup>	1996 <sup>a</sup>	1997	1998	Q1 <sup>a</sup>	Q2 <sup>a</sup>	Q3 <sup>a</sup>	Q4 <sup>a</sup>	Q1 <sup>a</sup>	Q2 <sup>b</sup>	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET																
Not seasonally adjusted																
Receipts <sup>1</sup>	1352	1453	1578	1619	322	446	362	346	349	496	386	357	364	505	393	382
Outlays <sup>1</sup>	1516	1560	1613	1681	393	392	395	405	401	396	411	423	418	420	419	470
Surplus/deficit <sup>1</sup>	-164	-107	-36	-62	-72	54	-33	-59	-52	100	-25	-66	-54	84	-26	-88
On-budget	-226	-174	-112	-144	-84	14	-36	-76	-69	61	-29	-78	-68	37	-36	-101
Off-budget	62	67	77	82	12	39	2	18	17	39	4	13	13	47	10	13
Surplus excluding deposit insurance <sup>2</sup>	-182	-116	-49	-67	-75	52	-35	-65	-56	97	-25	-67	-56	83	-27	-88
Means of financing																
Borrowing	171	130	56	69	80	-23	39	49	48	-69	28	44	50	-66	41	67
Cash decrease	-2	-6	5	0	-1	-16	-6	11	-1	-18	12	9	11	-15	-5	10
Other <sup>3</sup>	-5	-16	-25	-6	-7	-14	0	-1	5	-13	-15	13	-7	-3	-10	11
Cash operating balance, end of period	38	44	40	40	22	38	44	33	33	51	40	31	20	35	40	30
NIPA FEDERAL SECTOR																
Seasonally adjusted annual rate																
Receipts	1443	1550	1688	1758	1526	1584	1599	1642	1675	1706	1728	1746	1745	1761	1780	1795
Expenditures	1626	1679	1736	1792	1680	1695	1698	1719	1731	1745	1749	1774	1786	1795	1811	1829
Consumption expend.	445	447	460	466	445	454	454	454	458	467	460	463	465	465	469	468
Defense	300	302	309	308	298	308	309	308	306	314	308	308	308	307	309	307
Nondefense	145	145	151	158	146	146	145	146	152	153	152	154	157	159	160	161
Other expenditures	1182	1232	1276	1326	1235	1242	1244	1265	1273	1278	1289	1311	1321	1330	1342	1361
Current account surplus	-184	-129	-48	-34	-154	-112	-100	-77	-56	-39	-21	-28	-42	-34	-31	-34
Gross investment	67	69	62	63	72	71	68	64	58	61	64	64	63	62	63	63
Current and capital account surplus	-250	-197	-110	-97	-225	-183	-167	-141	-114	-100	-85	-92	-105	-97	-94	-97
FISCAL INDICATORS <sup>4</sup>																
High-employment (HEB) surplus/deficit	-265	-223	-177	-187	-241	-218	-202	-189	-178	-175	-166	-178	-193	-188	-187	-190
Change in HEB, percent of potential GDP	.2	-.6	-.6	.1	.1	-.3	-.2	-.2	-.1	0	-.1	.1	.2	-.1	0	0
Fiscal impetus (FI), percent, cal. year	-5.2	-2.3	-2.5	-1.4	2	1.1	-.5	-2.2	-1.1	1.1	-1.1	-.5	.3	-.8	.4	-2.1

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 2.0 percent real (chain-weighted) 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.

Strictly Confidential Class II FOMC  
August 14, 1997

Change in Debt of the Domestic Nonfinancial Sectors  
(Percent)

Period <sup>1</sup>	Total <sup>2</sup>	Federal government <sup>3</sup>	Nonfederal						Memo: Nominal GDP
			Total <sup>4</sup>	Households			Business	State and local governments	
				Total	Home mortgages	Consumer credit			
<i>Year</i>									
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	4.4	11.1	2.4	5.1	6.7	-1.7	-1.8	8.2	3.8
1992	4.8	10.9	2.8	5.3	6.2	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	5.0
1994	5.0	4.7	5.1	8.7	6.7	14.6	3.5	-3.4	5.8
1995	5.5	4.1	5.9	8.2	6.2	14.3	6.0	-3.5	4.0
1996	5.4	4.0	5.9	7.9	8.4	7.6	4.6	1.2	5.6
1997	4.7	1.3	5.9	6.4	7.2	5.3	6.1	3.0	5.0
1998	4.8	2.4	5.7	5.7	6.5	4.9	6.0	4.0	4.2
<i>Quarter</i>									
1996:1	6.4	6.6	6.3	9.4	10.0	11.0	4.3	-0.3	4.7
2	5.1	1.7	6.2	8.1	8.0	7.7	4.5	4.1	7.7
3	5.0	4.3	5.2	7.0	7.0	7.5	5.7	-5.7	3.6
4	4.6	3.1	5.2	6.1	7.5	3.5	3.7	6.7	6.2
1997:1	5.1	2.5	6.0	7.3	7.4	7.1	5.5	1.9	7.4
2	4.0	-2.2	6.2	6.0	7.0	3.7	6.0	7.7	4.2
3	4.6	2.8	5.2	5.9	6.8	5.0	6.1	-1.8	3.9
4	4.9	2.4	5.7	5.8	6.7	5.0	6.1	3.8	4.5
1998:1	4.6	2.5	5.3	5.7	6.5	4.9	5.5	2.5	4.4
2	4.1	-1.3	5.8	5.6	6.4	4.9	5.7	7.5	4.4
3	5.0	3.8	5.5	5.6	6.3	4.9	6.1	2.1	4.1
4	5.3	4.6	5.6	5.5	6.2	4.9	6.1	3.5	4.0

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 1997:Q1 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 5.3 percent in 1996, 4.7 percent in 1997, and 4.8 percent in 1998.

3. On a monthly average basis, federal debt rose 3.8 percent in 1996, 1.5 percent in 1997, and 2.1 percent in 1998.

4. On a monthly average basis, nonfederal debt increased 5.9 percent in 1996, 5.8 percent in 1997, and 5.7 percent in 1998.

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

Category	Calendar year				Seasonally adjusted annual rates							
					1997				1998			
	1995	1996	1997	1998	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<i>Net funds raised by domestic nonfinancial sectors</i>												
1 Total	661.4	680.6	611.4	673.4	678.3	516.4	617.8	632.8	648.0	558.7	713.4	773.4
2 Net equity issuance	-58.3	-64.2	-80.9	-69.6	-71.2	-76.0	-69.2	-107.2	-61.2	-69.6	-76.4	-71.2
3 Net debt issuance	719.7	744.8	692.3	743.0	749.5	592.4	687.0	740.0	709.2	628.3	789.8	844.6
<i>Borrowing sectors</i>												
<i>Nonfinancial business</i>												
4 Financing gap <sup>1</sup>	22.9	-25.4	-2.5	32.4	-1.0	5.2	-4.4	-9.7	22.2	24.1	41.6	41.9
5 Net equity issuance	-58.3	-64.2	-80.9	-69.6	-71.2	-76.0	-69.2	-107.2	-61.2	-69.6	-76.4	-71.2
6 Credit market borrowing	232.4	190.5	261.5	275.8	237.5	263.2	270.6	274.6	254.1	266.4	289.1	293.6
<i>Households</i>												
7 Net borrowing <sup>2</sup>	381.9	396.4	347.7	330.3	397.3	329.6	331.1	332.8	330.3	328.6	330.8	331.7
8 Home mortgages	198.6	282.3	261.5	255.0	271.5	260.0	256.9	257.7	256.7	255.2	253.6	254.7
9 Consumer credit	141.6	86.3	64.1	63.3	86.1	45.8	61.9	62.6	62.1	62.9	63.7	64.5
10 Deb/DPI (percent) <sup>3</sup>	90.6	93.4	95.5	96.5	94.7	95.5	95.9	96.2	95.9	96.4	96.7	97.0
<i>State and local governments</i>												
11 Net borrowing	-39.0	12.9	32.2	44.6	21.0	84.8	-19.6	42.8	28.4	85.2	24.4	40.4
12 Current surplus <sup>4</sup>	116.5	127.1	117.1	116.1	124.1	105.3	120.6	118.5	116.2	116.8	116.8	114.6
<i>Federal government</i>												
13 Net borrowing	144.4	145.0	50.8	92.2	93.7	-85.2	104.9	89.8	96.4	-51.9	145.5	178.9
14 Net borrowing (quarterly, n.s.a.)	144.4	145.0	50.8	92.2	48.0	-69.2	28.4	43.6	50.3	-66.3	41.3	66.8
15 Unified deficit (quarterly, n.s.a.)	146.3	110.6	42.4	84.2	52.0	-100.0	24.7	65.7	54.5	-84.1	26.1	87.8
<i>Depository institutions</i>												
16 Funds supplied	274.6	233.3	288.2	262.6	315.7	323.2	238.9	275.0	264.9	258.7	261.7	265.1
<i>Memo (percentage of GDP)</i>												
17 Domestic nonfinancial debt <sup>5</sup>	186.2	186.7	185.9	186.8	185.6	185.8	186.0	186.2	186.4	186.4	186.6	187.2
18 Domestic nonfinancial borrowing	9.9	9.8	8.6	8.8	9.4	7.4	8.5	9.0	8.6	7.5	9.4	9.9
19 Federal government <sup>6</sup>	2.0	1.9	0.6	1.1	1.2	-1.1	1.3	1.1	1.2	-0.6	1.7	2.1
20 Nonfederal	7.9	7.9	8.0	7.7	8.3	8.5	7.2	7.9	7.4	8.1	7.6	7.8

Note. Data after 1997:Q1 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.

## International Developments

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### Recent Developments

Since the first day of the July FOMC meeting, the weighted-average foreign exchange value of the dollar has risen slightly more than 4-1/4 percent in terms of the other G-10 currencies and a bit less in terms of a broader index that includes our major developing-country trading partners.<sup>1</sup> The dollar rose through July and early August, reaching a peak nearly 6 percent above its July 1 value. Over the most recent days, the dollar has retraced some of that gain.

The appreciation of the dollar has been uneven in terms of the other major industrial country currencies. Against the mark, the dollar has risen about 5-1/2 percent on balance. Continuing favorable developments in the U.S. economy have contrasted with the market's interpretations of some signs of sluggishness in Germany. In addition, events viewed as favorable to the start of EMU with a broad membership appear to have weighed on the mark and associated currencies.

On balance, the dollar has appreciated about 4-1/2 percent in terms of sterling. The Bank of England raised its repo rate 25 basis points on two occasions during this period, for a total of 100 basis points since May. Following the most recent increase, the Bank's Monetary Policy Committee noted that interest rates were now at levels consistent with the inflation target and suggested further increases were unlikely in the near term. Concerns about the prospects for U.K. exports and manufacturing output have contributed to some movement back down of sterling from recent highs.

In terms of the yen, the dollar is up 1-1/2 percent on balance. The yen/dollar rate has moved in response to news about the Japanese external balances and to perceptions of weak Japanese economic activity during the second quarter. News of disappointing Japanese economic performance, as reflected in industrial production, retail sales, and domestic auto sales, along with spillover from depreciation of several Southeast Asian currencies, contributed to downward pressure on the yen. Late in the period, news of the current account surplus in June may have rekindled concerns about Japanese external balances and helped to trigger yen appreciation.

On average, long-term market interest rates edged down in the major foreign industrial countries, while U.S. ten-year Treasury rates decreased a bit more. Rates in Japan declined 24 basis points and those in Canada 34 basis points.

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1. In addition to the currencies of the G-10 countries (Japan, Germany, France, the United Kingdom, Canada, Italy, Sweden, Belgium, the Netherlands, and Switzerland), the broader G-18 index includes the currencies of Chile, Mexico, Hong Kong, Malaysia, the Philippines, Singapore, South Korea, and Taiwan.

The dollar has risen about 3 percent against an index of eight major developing country currencies over the intermeeting period. Intense exchange market pressures in some Asian countries in July resulted in appreciation of the dollar in terms of several of their currencies. The currencies of Thailand and the Philippines have depreciated; Indonesia's exchange rate band has been abandoned; and the currencies of Malaysia and Singapore have experienced downward market pressure. In contrast, the Mexican peso has appreciated about 1-3/4 percent in terms of the dollar over the intermeeting period as Mexican congressional elections proceeded without incident. In order to counter recent peso strength, Mexican officials increased the amount of their most recent offering of dollar put options and planned future amounts.

The Desk did not intervene, bringing to two years the time since intervention by U.S. authorities.

Available indicators suggest that economic activity expanded further during the second quarter in all the major foreign industrial countries except Japan. The very limited data released so far for the third quarter and forward-looking survey data imply that output growth continues. In Germany, production data for the second quarter show further output growth. Real manufacturing orders and business sentiment improved sharply. However, through July, German unemployment increased further to 11.5 percent. In the United Kingdom, real GDP grew at an annual rate of 3.5 percent in the second quarter. The unemployment rate fell further to 5.5 percent in July, 1.2 percentage points below its end-1996 level. Canadian indicators of production and spending show further expansion in the second quarter. Employment rose substantially in the second quarter and edged up further in July, while the unemployment rate declined to 9 percent, bringing the total decline in that rate for this year to 0.7 percentage points. In Japan, weakness of industrial production, housing starts, and new car registrations in the second quarter reflects the payback from strong spending in advance of the April 1 increase in the consumption tax. Increases in machinery orders in the second quarter suggest rising investment spending ahead.

Inflation in the foreign G-7 countries remains subdued. For the latest months, twelve-month increases in consumer prices continued below 2 percent in all these countries (including Italy) except the United Kingdom. U.K. retail prices excluding mortgage interest rates were 3.0 percent above their year-earlier level in July, above the government's inflation target. German 12-month inflation has moved up slightly to 1.9 percent.

In recent months, real output growth has generally remained strong in the major Latin American and Asian countries. In Mexico, data for industrial production and retail sales through May show continued growth supported by emerging strength in domestic demand. Second-quarter output measures for Argentina, Taiwan and Korea also show vigorous growth.

The U.S. nominal trade deficit on goods and services widened in May as exports fell and imports rose. For the average of April and May, the deficit, at an annual rate, was slightly smaller than that recorded in the first quarter. Exports of goods and services expanded 3-1/2 percent in April/May, led by increases in machinery and aircraft. Imports grew 3 percent in April/May, with consumer goods, computers, and machinery showing strong gains while the value of oil imports declined. The quantity of oil imports rose sharply, however, in April/May, a result of extremely strong consumption. Preliminary data indicate that the quantity of oil imports remained strong in June and July.

Prices of nonagricultural exports were about unchanged on average in the second quarter, while prices for agricultural exports declined sharply. Prices of non-oil imports increased slightly in June, although they decreased moderately on average in the second quarter. The price of imported oil increased slightly in May and a bit faster in June. The June increase reflected concern about renewal of the Iraqi oil-for-food arrangement, since resolved. However, the second-quarter average price of imported oil was significantly below that of the first quarter. Prices for spot WTI oil rose \$0.46 per barrel in July, in response to continuing concerns about reduced Iraqi exports and disruption of supply from Colombia because of terrorist activity. Currently, spot WTI prices are about \$20 per barrel.

## Outlook

Our forecast for real net exports reflects slight modifications to our outlook for income growth here and abroad since the June Greenbook and upward revision to our projected path for the dollar.<sup>2</sup> We forecast that total foreign real output will grow at about an annual rate of 4 percent during the second half of this year and slow slightly next year, little changed from the June Greenbook. The projected path for U.S. real GDP growth has been revised down slightly. The favorable effects of these changes

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2. Our forecast has also been affected by the change in BEA methodology from using a Laspeyres index for the most recent quarters to using a chain-weighted index. We estimate that the change in methodology accounts for -1.9 and -1.7 percentage points of the -2.9 and -1.3 percentage point revisions to projected growth for real exports and real imports, respectively, in 1998.

for U.S. real net exports are more than offset by the implications of a stronger path for the dollar over the forecast period. As a consequence, the negative contribution of real net exports to U.S. real GDP growth is projected to be about 0.5 percent over the forecast period, slightly greater than in the June Greenbook.

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

Measure	1997				1998
	Q1	Q2	Q3	Q4	
Foreign output	3.3	4.2	4.1	4.1	3.9
Previous	3.3	4.6	4.0	4.1	3.9
Real exports	9.9	14.0	2.3	8.9	4.4
Previous	10.7	13.8	4.0	11.3	7.3
Real imports	17.9	19.9	5.4	6.3	7.2
Previous	19.7	17.3	10.4	7.6	8.5

**The dollar.** We have raised the path of the dollar relative to that in the June Greenbook in light of the recent appreciation. We continue to assume that a growing U.S. current account deficit will lead to downward pressure on the dollar during the forecast period, though we remain agnostic about the timing and extent of those pressures. The dollar is expected to decline slightly against the mark and the other currencies of the ERM. For these currencies, the risk premium associated with the approach of the start of a common currency in the European Monetary Union is expected to offset much of the negative effects on the dollar of the projected widening of the U.S. current account deficit. The dollar is expected to depreciate significantly against the yen, as concerns about Japan's growing external surpluses are expected to be particularly acute. On average, we expect the dollar to depreciate somewhat from recent elevated levels over the remainder of the forecast period in terms of the G-10 countries. The dollar is also expected to depreciate against the currencies of key developing countries, resulting in an average rate of decline in terms of the G-18 index for the dollar that is somewhat more than that for the G-10 index.

**Foreign G-7 countries.** We project that real output in the foreign G-7 countries (weighted by U.S. nonagricultural export shares) will grow at an annual rate of about 3 percent during the second half of this year and then slow a bit to 2-3/4 percent next year. This pattern reflects our expectation that the near-term strength in some of these countries, particularly Canada and the United Kingdom, will moderate

somewhat next year in response to tighter monetary conditions. On average over the forecast period, our projected path for G-7 output is little changed from the June Greenbook.

Growth of Japanese real GDP is projected to rebound this quarter following an unexpectedly large decline in the second quarter. Output growth is expected to average about 2-1/2 percent per year over the remainder of this year and next as consumption growth recovers and net exports continue to make a positive but declining contribution to growth. In Germany, real GDP growth is projected to slow some during the current quarter, following a weather-related rebound in the second quarter; it should strengthen over the forecast period, reaching 2-3/4 percent in 1998, as net exports continue to benefit from the sharp depreciation of the mark.

In the United Kingdom, monetary tightening, a substantial part of which is already in place, is projected to slow output growth over the forecast period from about 3-1/4 percent during the first half of this year to slightly below 2 percent by the end of next year. The ongoing effects of recent strength in sterling on net exports should contribute to the deceleration of output as well. Continued signs of strength in Canada have led us to revise up slightly our near-term projection for real GDP growth; we now expect that output will expand at a 3-3/4 percent annual rate during the second half of this year before slowing to about 3 percent next year. Surging business and consumer confidence measures suggest that stronger investment spending and personal consumption expenditures should boost output growth for the next several quarters.

Our forecast for consumer price inflation in the foreign G-7 (weighted by U.S. non-oil import shares) has been revised up slightly since the June Greenbook but still calls for average inflation abroad to remain below 2 percent. We now expect that the impact on Japanese inflation of the increase in the consumption tax will be somewhat larger over the remainder of this year than we previously projected. We have raised the projection for Canadian inflation for the rest of this year and next in light of stronger economic activity. For the United Kingdom, projected inflation has been lowered in the near term in response to sterling appreciation since mid-1996 but has been raised for 1998 as that economy continues to operate close to potential.

Our forecast incorporates the assumption that average short-term market interest rates will be about unchanged in the major foreign industrial countries as increases in several of the countries are offset by sizable declines in Italy that arise from convergence to a common European level by 1999. In Germany, we expect an increase in the near term of about 1/4 percentage point, triggered by an increase in

official rates, and then no further policy steps prior to the introduction in January 1999 of a common monetary policy within the EMU. Monetary policy actions are also assumed to give rise to higher market rates in Japan, Canada, and the United Kingdom. Long-term rates are assumed to move up somewhat abroad as activity continues to expand--except in Italy, where EMU considerations lead us to expect some further decline in long-term rates.

**Other countries.** Real GDP in our major developing-country trading partners is projected to increase about 5-1/2 percent in 1997 (Q4/Q4), slightly less than in the June Greenbook as a result of downward revisions to forecasts for several Asian countries.

The projection for real GDP growth in Asia during 1997 has been marked down to about 6-1/4 percent. The forecast for Korea was lowered more than 1/2 percentage point in response to further revelations of fragility in the country's corporate and financial sectors. Our GDP forecasts for several Southeast Asian countries--the Philippines, Singapore and Malaysia--have been lowered because of expected disruptive effects of turmoil in their currency markets and weakness in their financial sectors that resulted from a build-up of questionable investment assets, particularly in the property sectors. We expect domestic demand in these countries to be weakened by increases in short-term interest rates, which remain at elevated levels as a result of their (largely futile) attempts to stave off depreciations of their currencies. We expect real GDP growth in 1998 to recover somewhat in the Asian developing countries, bolstered by continued strength in world industrial activity and trade and by some gains in competitiveness owing to yen appreciation.

Our outlook for real GDP growth in Latin America has been revised upward a bit from the last Greenbook to reflect stronger-than-expected investment demand in Mexico and Argentina. We expect robust growth--4-3/4 per year--in Mexico during 1997-98. The increases in real GDP, combined with a strengthening of the real value of the peso, are expected to result in a widening of the current account deficit in Mexico from \$1.2 billion in 1996 to \$6 billion in 1997. In Argentina, we project 1997 growth of nearly 5-1/2 percent, 1/2 percentage point more than in the June Greenbook. Projected growth in 1998 has been raised slightly less, to 6-1/4 percent. Though our forecasts for Brazil have not changed, there is some downside risk because of indications of an increased likelihood of some financial market turmoil.

**U.S. real exports and imports.** We project that real exports of goods and services will decelerate over the forecast period. After expanding at an annual rate of 12 percent in the first half of this year, real exports should increase 5-1/2 percent at an

annual rate during the second half of the year and 4-1/2 percent during 1998. Rapid growth in sales of computers and semiconductors should continue to boost exports, but the extremely high rates of growth recorded for computers during the first half of the year are not expected to be matched over the rest of the forecast period. Exports of nonagricultural goods other than computers and semiconductors are projected to expand at an annual rate of about 4 percent during the second half of 1997 and then to slow further to about 1/2 percent during 1998. Sustained output growth in our trading partners contributes to continued growth of exports, but the lagged effects of the recent appreciation of the dollar significantly reduce exports during the remainder of this year and even more next year.

Real imports of goods and services are also projected to slow over the forecast period, from an annualized rate of 19 percent during the first half of this year to about 6-1/2 percent over the remainder of the forecast period. Imports of computers and semiconductors should continue to grow rapidly but at rates that diminish somewhat through the end of the forecast. Non-oil imports other than computers and semiconductors are projected to grow at an annual rate of about 4-3/4 percent over the remainder of the forecast period, considerably less than the 17 percent rate recorded for the first half of this year. The slowdown in U.S. real GDP growth contributes importantly to restraining import growth. By next year, the effects of projected dollar depreciation should be a factor reducing import growth, as well. We expect the quantity of oil imports to decline during the second half of this year from the surprisingly high second-quarter rates and then to rise during the remainder of the forecast period as consumption rises and U.S. production declines.

**Oil prices.** We have raised our projections slightly for the price of imported oil in the near term because of the delay in Iraqi shipments and the interruption of oil export flows from Colombia. For the third quarter, the price has been revised up \$0.45 per barrel, to \$16.90. We project that import prices will fall to near \$16 per barrel during the fourth quarter with the return of Iraqi and Colombian exports to the world market and increases in North Sea production. We project the WTI spot price and the oil import unit value to return to \$19.50/b and \$17.00/b, respectively, by the last half of 1998.

**Prices of non-oil imports and exports.** Prices of non-oil imports are projected to continue to fall over the forecast period but at a diminishing rate. The recent appreciation of the dollar has been a factor lowering import prices during last year and so far this year, but the dollar's negative effect should wane and then be slightly reversed next year in line with the staff's projection of some dollar

depreciation. Non-oil import prices should also be restrained during the remainder of this year and next by declines in non-oil global commodity prices as the recent runup in these prices (primarily coffee, foodstuffs and metals prices) is reversed. Prices of nonagricultural exports are forecast to continue declining at a gradually slowing rate over the forecast period. Falling computer and semiconductor prices should contribute to declines in the prices of both nonagricultural exports and non-oil imports.

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

Trade category	Projection				
	1997				1998
	Q1	Q2	Q3	Q4	
<i>Exports</i>					
Nonagricultural	-2.5	-2.5	-3.4	-2.7	-1.4
Agricultural	2.0	-21.8	-7.7	2.0	2.0
<i>Imports</i>					
Non-oil	-4.2	-4.3	-3.2	-0.4	-1.2
Oil (level, dollars per barrel)	21.31	17.90	16.90	16.11	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.

**Nominal trade and current account balances.** The nominal trade balance is projected to widen on net over the forecast period from about \$118 billion in the second quarter of this year to \$145 billion in the final quarter of next year. The balance on net investment income is expected to deteriorate through the end of next year as well. Accordingly, the current account deficit, which was \$148 billion in 1996, is projected to reach \$210 billion in 1998, about 2-1/2 percent of GDP.

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
<b>REAL GDP</b>									
Canada	-1.9	0.0	0.5	3.1	4.9	0.7	2.3	3.9	3.1
France	1.4	1.3	0.0	-0.6	4.3	0.3	2.1	2.6	2.5
Germany (1)	6.8	3.3	1.0	-0.2	3.4	0.8	2.2	2.4	2.8
Italy	0.7	1.9	-0.8	0.1	2.7	2.3	0.2	1.7	2.4
Japan	5.1	2.5	0.1	0.4	0.8	2.6	3.0	1.7	2.5
United Kingdom	-0.7	-1.6	0.4	2.7	4.9	2.0	2.9	3.1	1.9
Average weighted by 1991 GDP	3.0	1.7	0.2	0.6	2.9	1.7	2.3	2.3	2.5
Average weighted by share of U.S. nonagricultural exports									
Total foreign	2.5	2.9	1.9	3.2	5.1	1.7	4.0	3.9	3.9
Foreign G-7	0.7	0.8	0.3	1.8	3.9	1.3	2.4	3.0	2.8
Developing Countries	6.2	6.4	5.1	6.0	7.0	2.1	6.8	5.6	5.9
<b>CONSUMER PRICES</b>									
Canada	4.9	4.1	1.8	1.8	0.0	2.1	2.0	1.9	2.0
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	1.8	1.8
Italy	6.4	6.1	4.9	4.1	3.8	5.9	2.7	1.8	2.0
Japan	3.2	3.2	0.9	1.2	0.8	-0.8	0.1	1.8	0.6
United Kingdom (2)	9.2	5.7	3.7	2.7	2.2	2.9	3.2	2.4	2.9
Average weighted by 1991 GDP	4.5	4.1	2.4	2.5	1.8	1.6	1.5	1.8	1.6
Average weighted by share of U.S. non-oil imports									
	4.3	3.9	1.9	2.0	1.0	1.1	1.3	1.8	1.5

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

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

Measure and country	1996				1997				Projected 1998			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>REAL GDP</b>												
Canada	1.4	1.4	3.3	2.9	3.4	4.4	3.9	3.6	3.4	3.3	3.1	2.8
France	5.1	-0.6	3.3	0.9	1.0	4.2	2.7	2.4	2.6	2.4	2.5	2.4
Germany	-0.4	6.1	3.0	0.3	1.8	3.3	2.0	2.4	2.7	2.9	2.8	2.7
Italy	1.7	-1.8	2.9	-1.9	-0.7	3.4	2.0	2.0	2.3	2.3	2.5	2.5
Japan	8.4	-1.1	1.3	3.8	6.6	-4.5	2.3	2.5	2.7	2.5	2.4	2.4
United Kingdom	2.3	2.6	2.2	4.4	3.3	3.6	2.8	2.6	2.2	2.0	1.9	1.7
Average weighted by 1987-89 GDP	4.0	0.9	2.4	1.9	3.2	0.9	2.5	2.5	2.6	2.5	2.5	2.4
Average weighted by share of U.S. nonagricultural exports												
Total foreign	4.7	1.9	4.6	4.9	3.3	4.2	4.1	4.1	4.0	4.0	3.9	3.9
Foreign G-7	3.0	1.2	2.7	2.7	3.6	2.3	3.1	3.0	2.9	2.8	2.7	2.6
Developing Countries	8.9	1.6	7.7	9.2	3.9	6.8	5.8	5.9	5.9	6.0	5.8	5.9
<b>CONSUMER PRICES (1)</b>												
Canada	1.4	1.4	1.4	2.0	2.1	1.6	1.9	1.9	1.9	2.1	2.0	2.0
France	2.1	2.4	1.8	1.7	1.5	0.9	1.3	1.4	1.6	1.7	1.8	1.9
Germany	1.6	1.5	1.4	1.4	1.7	1.6	1.8	1.8	1.8	1.8	1.8	1.8
Italy	5.0	4.2	3.5	2.7	2.4	1.6	1.8	1.8	2.0	2.0	2.0	2.0
Japan	-0.3	0.1	0.0	0.1	0.0	1.5	1.8	1.8	2.0	0.2	0.4	0.6
United Kingdom (2)	2.9	2.8	2.9	3.2	2.9	2.6	2.8	2.4	2.4	2.5	2.7	2.9
Average weighted by 1987-89 GDP	1.6	1.7	1.5	1.5	1.4	1.6	1.9	1.8	1.9	1.4	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	1.9	1.8	2.0	1.3	1.4	1.5

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	1996	-- Projected -- 1997	1998
<b>NIPA REAL EXPORTS and IMPORTS</b>									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	0.6	0.4	-0.4	-0.6	-0.4	0.4	-0.4	-0.6	-0.5
Exports of G&S	0.6	0.8	0.4	0.5	1.1	1.2	1.1	1.1	0.6
Imports of G&S	-0.0	-0.4	-0.8	-1.1	-1.4	-0.7	-1.6	-1.7	-1.1
	Percentage change, Q4/Q4								
Exports of G&S	7.2	8.6	4.1	4.6	10.0	10.3	9.3	8.7	4.4
Services	8.9	7.1	-0.9	4.1	6.0	9.0	4.7	1.3	4.0
Agricultural Goods	-7.3	10.1	10.4	-5.5	16.6	-3.4	5.7	-1.1	2.4
Computers	12.3	21.7	25.2	23.7	32.0	55.7	33.8	57.1	37.3
Semiconductors	61.5	41.8	64.8	32.9	66.9	80.4	45.9	26.1	27.9
Other Goods 1/	6.0	7.0	2.3	3.6	6.9	5.7	7.6	9.1	0.6
Imports of G&S	0.5	4.1	7.4	10.2	12.3	5.6	11.8	12.2	7.2
Services	5.8	-2.7	1.4	3.2	1.4	7.3	5.0	9.9	2.4
Oil	-15.8	8.1	12.1	10.1	-0.2	1.5	8.3	-6.5	7.5
Computers	2.9	35.9	45.1	39.3	44.8	46.2	23.6	52.8	36.0
Semiconductors	60.9	55.3	42.0	34.2	54.5	92.7	57.9	33.8	27.4
Other Goods 2/	-0.3	2.5	5.4	9.5	12.2	-1.2	10.5	10.4	4.9
	Billions of chained 1992 dollars								
Net Goods & Services	-61.9	-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-143.4	-181.5
Exports of G&S	564.4	599.9	639.4	658.2	712.4	791.2	857.0	953.6	1003.1
Imports of G&S	626.3	622.2	669.0	728.4	817.0	890.1	971.5	1097.0	1184.5
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-91.0	-4.5	-55.4	-90.5	-133.5	-129.1	-148.2	-172.7	-210.2
Net Goods & Services (BOP)	-80.3	-29.9	-38.3	-72.0	-104.4	-101.9	-111.0	-116.3	-140.9
Exports of G&S (BOP)	536.8	580.7	617.7	643.0	699.7	794.6	848.8	920.4	959.8
Imports of G&S (BOP)	617.1	610.6	655.9	715.0	804.1	896.5	959.9	1036.7	1100.7
Net Investment Income	23.9	20.3	18.0	19.7	9.7	6.8	2.8	-15.7	-27.6
Direct, Net	55.9	55.6	51.6	55.7	50.8	60.0	66.8	65.6	68.1
Portfolio, Net	-31.9	-35.4	-33.6	-36.0	-41.0	-53.2	-63.9	-81.4	-95.7
Net Transfers	-34.6	5.1	-35.2	-38.1	-38.8	-34.0	-40.0	-40.7	-41.8

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

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	-0.9	-0.5	-1.3	0.2	-1.1	-0.4	-0.4	0.3	-0.5	0.0	1.2	1.0
Exports of G&S	-0.1	0.8	-0.9	2.1	-0.2	1.7	1.1	1.5	0.8	1.0	1.5	1.3
Imports of G&S	-0.8	-1.3	-0.4	-1.9	-0.9	-2.1	-1.5	-1.2	-1.2	-1.0	-0.3	-0.3
	Percentage change from previous period, SAAR											
Exports of G&S	-1.2	8.2	-8.1	21.9	-1.8	17.7	10.6	14.7	7.2	9.3	13.5	11.5
Services	10.8	3.7	-1.3	3.4	2.4	12.9	2.0	6.9	6.0	3.8	20.3	6.6
Agricultural Goods	-17.7	1.0	-24.1	26.5	-25.2	8.1	45.3	57.2	-1.3	-17.5	19.7	-10.7
Computers	10.0	15.2	38.1	33.5	21.4	24.3	35.5	48.4	34.9	41.0	89.6	63.1
Semiconductors	41.2	21.6	53.5	18.4	111.8	23.4	65.9	79.1	72.0	97.0	100.3	56.2
Other Goods 1/	-7.4	10.3	-14.5	31.9	-6.8	20.3	7.4	8.6	2.9	8.2	1.0	11.0
Imports of G&S	7.6	12.4	3.8	17.7	7.6	19.0	13.1	9.9	10.0	7.7	2.3	2.4
Services	-12.2	5.3	4.7	17.1	2.7	4.1	-0.4	-0.9	24.4	-4.0	8.4	2.2
Oil	5.2	36.0	-7.0	10.4	-8.6	27.2	33.5	-36.2	-8.1	12.5	28.0	-19.7
Computers	43.8	44.3	38.3	31.3	32.9	48.3	42.3	57.0	8.1	57.3	65.8	61.8
Semiconductors	79.3	25.6	-1.3	46.1	60.7	23.7	74.4	64.3	29.6	108.0	157.1	98.8
Other Goods 2/	9.5	9.3	2.9	16.7	6.9	19.6	10.3	12.5	7.3	2.2	-10.0	-3.6
	Billions of chained 1992 dollars											
Net Goods & Services	-54.7	-62.6	-83.1	-80.5	-97.6	-103.9	-111.1	-105.9	-113.5	-112.8	-92.9	-76.1
Exports of G&S	647.2	660.1	646.3	679.1	676.0	704.1	722.1	747.3	760.4	777.4	802.4	824.6
Imports of G&S	701.9	722.7	729.4	759.7	773.6	808.0	833.2	853.2	873.9	890.3	895.4	900.7
	Billions of dollars											
US CURRENT ACCOUNT BALANCE	-63.8	-89.1	-99.2	-109.9	-104.6	-128.0	-145.5	-156.1	-138.8	-142.8	-132.5	-102.2
Net Goods & Services (BOP)	-54.2	-72.1	-84.8	-77.0	-90.6	-101.5	-114.0	-111.6	-113.2	-123.2	-95.5	-75.5
Exports of G&S (BOP)	631.8	642.7	631.8	665.5	662.5	688.4	710.9	736.8	761.5	785.9	806.4	824.6
Imports of G&S (BOP)	686.1	714.8	716.6	742.5	753.1	789.9	824.9	848.4	874.7	909.1	901.9	900.1
Net Investment Income	24.4	17.1	23.0	14.2	17.9	10.6	7.2	3.3	8.2	12.9	-1.6	7.8
Direct, Net	61.0	53.9	58.6	49.2	51.7	48.9	51.0	51.5	57.6	64.1	53.9	64.5
Portfolio, Net	-36.6	-36.8	-35.6	-35.0	-33.8	-38.3	-43.8	-48.2	-49.4	-51.3	-55.5	-56.7
Net Transfers	-34.0	-34.0	-37.4	-47.1	-31.9	-37.1	-38.7	-47.7	-33.8	-32.5	-35.4	-34.5

1. Merchandise exports excluding agricultural products, computers, and semiconductors.

2. Merchandise imports excluding oil, computers, and semiconductors.

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1996				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	-1.5	-0.7	-1.5	1.9	-1.2	-1.0	-0.5	0.2	-1.0	-0.4	-1.1	0.5
Exports of G&S	0.2	1.1	0.2	2.9	1.2	1.7	0.3	1.2	0.3	0.9	0.1	1.1
Imports of G&S	-1.7	-1.8	-1.7	-0.9	-2.4	-2.7	-0.8	-1.0	-1.3	-1.4	-1.2	-0.6
	Percentage change from previous period, SAAR											
Exports of G&S	1.7	9.6	1.9	25.5	9.9	14.0	2.3	8.9	2.2	7.1	0.5	8.2
Services	-3.8	9.7	0.3	13.5	3.7	0.5	-0.7	1.8	3.5	4.2	4.2	4.1
Agricultural Goods	12.5	-34.3	13.1	49.2	-27.6	18.1	2.4	9.3	3.3	1.6	1.7	3.2
Computers	46.2	31.8	29.2	28.7	72.3	73.7	44.3	41.2	37.3	37.3	37.3	37.3
Semiconductors	19.9	28.3	37.6	113.8	39.0	13.3	26.2	27.2	27.9	27.9	27.9	27.9
Other Goods 1/	-1.2	13.2	-3.1	23.9	12.4	16.7	-0.9	8.8	-3.0	5.2	-6.2	7.0
Imports of G&S	13.1	14.1	13.2	6.8	17.9	19.9	5.4	6.3	8.4	8.9	7.5	3.9
Services	14.6	2.7	1.2	2.1	24.2	7.5	4.8	4.1	3.0	2.1	2.2	2.2
Oil	-7.6	67.2	10.6	-19.6	-10.8	30.8	-2.3	-32.9	19.3	39.6	15.4	-30.5
Computers	6.4	30.7	26.9	32.0	51.3	81.0	43.8	38.6	36.0	36.0	36.0	36.0
Semiconductors	30.4	10.3	75.5	146.4	71.2	7.1	33.5	31.1	27.4	27.4	27.4	27.4
Other Goods 2/	14.5	11.0	12.2	4.3	15.3	18.0	1.9	7.1	5.6	5.1	4.7	4.1
	Billions of chained 1992 dollars											
Net Goods & Services	-100.8	-112.6	-138.9	-105.6	-126.3	-144.2	-153.4	-149.8	-167.5	-175.4	-195.7	-187.3
Exports of G&S	828.2	847.4	851.4	901.1	922.7	953.4	958.8	979.5	984.7	1001.7	1002.9	1022.9
Imports of G&S	929.0	960.0	990.2	1006.6	1048.9	1097.6	1112.2	1129.3	1152.3	1177.1	1198.6	1210.2
	Billions of dollars											
US CURRENT ACCOUNT BALANCE	-131.5	-142.3	-171.3	-147.5	-163.8	-169.2	-174.3	-183.7	-194.2	-200.6	-222.2	-223.9
Net Goods & Services (BOP)	-98.2	-111.1	-130.1	-104.8	-116.5	-117.6	-118.3	-113.0	-130.2	-135.1	-153.9	-144.4
Exports of G&S (BOP)	828.4	848.6	840.3	878.0	898.1	926.1	919.7	937.7	941.9	958.3	959.7	979.4
Imports of G&S (BOP)	926.6	959.7	970.4	982.8	1014.5	1043.6	1038.0	1050.7	1072.0	1093.4	1113.6	1123.9
Net Investment Income	8.2	3.5	-5.5	5.0	-12.6	-12.6	-17.0	-20.7	-25.1	-26.5	-29.3	-29.5
Direct, Net	66.2	64.2	60.3	76.4	65.0	66.4	65.9	65.3	64.2	66.5	68.6	73.2
Portfolio, Net	-57.9	-60.7	-65.7	-71.4	-77.5	-79.0	-82.9	-86.0	-89.3	-93.0	-97.9	-102.6
Net Transfers	-41.6	-34.8	-35.8	-47.7	-34.8	-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.