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Strictly Confidential (FR) Class II FOMC

November 9, 1994

SUMMARY AND OUTLOOK

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

Overview

Economic activity has continued to grow at an impressive clip in recent months. Indeed, the strength of October's labor market report suggests the distinct possibility of an acceleration in output this quarter, in contrast to our prior forecast of a slight moderation. Domestic final demand has held up well in the face of higher interest rates, while the tightening of supplies and favorable sales trends appear to be buoying business demand for inventory. Contributing to the resiliency of the economy is the more aggressive lending posture of banks and other intermediaries, which has tended to offset some of the financial restraint that might otherwise have been expected to be associated with a tightening of monetary policy. In addition, the further depreciation of the dollar and a brisker recovery abroad portend somewhat more external impetus to domestic production than we anticipated in the September Greenbook.

With the unemployment rate at 5-3/4 percent and the use of industrial capacity near 85 percent, the economy is now past the point of full, noninflationary utilization of productive resources. Because this development is recent, its inflationary consequences have yet to surface fully. The recent acceleration in average hourly earnings hints at some firming in wages, but, at least through September, overall compensation increases were moderated by favorable developments on the benefits side. With unit labor costs still increasing only slowly, and probably falling in manufacturing, price increases for final goods and services have remained relatively subdued to date. However, firms increasingly report that they are expecting to pass through some of the large increase in materials costs that they have experienced in the past year, and these pressures are reflected in our forecast of some pickup in core CPI inflation in the next several months.

Moreover, we believe that this near-term spurt in price increases could easily evolve into a deterioration in the ongoing trend of inflation unless the pace of economic expansion slows decidedly in the next few quarters. Although we would expect a damping influence from a slowing of inventory accumulation even under current financial conditions, our judgment is that restoring sustainable levels of resource utilization will also require some additional restraint on domestic final demand. Consequently, we have based our projection on the assumption of an appreciable further tightening of money market conditions.

Under this assumption, growth of aggregate demand is projected to slow markedly through mid-1995, and real GDP expansion is expected to remain well below the pace of potential output growth into early 1996. The easing of pressures on resources--and the reversal of the "speed effects" associated with the recent rapid pace of expansion--are expected to rein in the incipient acceleration of inflation. On balance, real GDP is projected to increase just 1-1/2 percent in 1995 and 2-1/4 percent in 1996, and consumer price inflation is expected to end the period not much above the 3 percent pace that we have experienced over the past year.

Key Assumptions

In recent weeks, long-term interest rates have moved a little higher than was anticipated in the last Greenbook--a development entirely consistent with the surprises in the economic news. Given the impressive resiliency of demand, we have raised our interest rate path slightly (in nominal and real terms) in this forecast. But, while short-term rates are assumed to increase appreciably over the next several months, we think it probable that such a tightening will not exact much of a toll from bond prices. More likely, the yield curve will flatten substantially as market participants become convinced that aggregate demand is softening enough to curb inflationary pressures. We are projecting that nominal long term rates will drop significantly below current levels by 1996.

Fiscal policy is assumed to remain generally restrictive. After a blip in defense outlays in the third quarter, defense spending should resume its contraction. Although the outcome of the congressional election promises to produce active debate about fiscal policies, we do not foresee any major alteration in the direction of the federal budget within the projection horizon and continue to assume a path for federal outlays consistent with the constraints imposed by OBRA-93. The unified budget deficit, which ended FY1994 at $203 billion, is projected at $188 billion in FY1995 and $205 billion in FY1996.

The recent weakness of the dollar on exchange markets was not foreseen in the last Greenbook, and the current projection anticipates that the dollar will firm a bit from the recent level over the medium term and then remain unchanged--at a level nearly 2 percent lower, on a trade-weighted basis, than in the September forecast. We expect the dollar to be buttressed initially by the near-term policy tightening and later by a pattern of economic developments that bolsters confidence in our willingness and ability to control inflation, even if interest rates do not rise as far as the markets seem to be anticipating. In addition, incoming information on economic activity abroad has prompted another small upward revision to our forecast of foreign GDP growth. On an export-weighted basis, foreign GDP is expected to rise at just under a 4 percent annual rate through the end of the projection period.

Oil markets have firmed somewhat earlier than we had previously anticipated, and the spot price of WTI is now near the $18.50 per barrel level, where we expect it to hold for the remainder of the projection period.

Recent Developments and the Outlook for the Current Quarter

We are projecting that real GDP will grow at about a 4 percent annual rate in the current quarter. At this stage, the available information on activity consists principally of the October labor market report and a few data on output in the industrial sector. The low level of initial claims for unemployment insurance points to sustained growth of payrolls into November. Even if the jump in the average workweek in October is reversed, aggregate hours of private production workers appear headed for a quarterly increase of 5 percent or more (annual rate). However, we are anticipating that labor productivity will change little, after spurting in the third quarter.

The data on hours worked in manufacturing and the available physical output indicators point to a big increase in factory production this quarter. Purchasing managers and other industry contacts generally report strong order flows, with capacity limiting production in some instances. Motor vehicle producers have recently had some difficulty getting assemblies up to the levels that they need in order to allow dealers to restock models in short supply; nonetheless, they remain optimistic that production of light vehicles will ramp up from the recent pace of less than 12 million units (annual rate) to a 12-3/4 million unit rate in November and December. All told, the motor vehicle sector should contribute almost 1 percentage point to growth of factory output this quarter and almost 1/2 percentage point to GDP growth.

The strength of production and hiring in recent months appears to reflect an assessment by businesses that final demand will remain buoyant through year-end, and we share that view: We are projecting that production gains this quarter will be more than absorbed by final sales. Although we expect inventory accumulation to be less than in the third quarter, we believe that tighter supplies and a desire to assume that stocks are sufficient to satisfy rising demand will encourage businesses to maintain a relatively high rate of inventory investment for a while longer.[1]

Real personal consumption expenditures are projected to post a relatively robust gain--roughly 4-1/2 percent--in the current quarter. The recent labor market report points to a large increase in wage and salary income, and consumer attitudes--including opinions about buying conditions and the willingness to use credit and savings--remain generally favorable. Sales of light vehicles in October were well above the average for the third quarter, and improving supplies of popular models should help sustain strong sales in the near term.

Growth of business fixed investment is expected to remain rapid this quarter. Orders for nondefense capital goods have continued to trend up smartly, with strong demand for a broad range of industrial machinery as well as acceleration in bookings for computers.

1. Based on the current-cost data on manufacturing and wholesale trade inventories for September, the BEA's estimated change in nonfarm stocks in the third quarter appears to have been roughly $12 billion (annual rate) too high. That is, the change in nonfarm stocks last quarter may have been around $45 billion (annual rate), down from the second-quarter pace of almost $52 billion.

Because our forecast provides our best estimate of growth of real GDP, we have "artificially" added $12 billion to our projections of the level of inventory investment so that the quarterly changes in inventory investment will accurately reflect our best guess of their contribution to overall growth.

Although we now believe that inventory investment was lower than BEA estimated in the third quarter, incoming data have pointed to a partially offsetting upward revision to final sales, principally business fixed investment. On balance, we think that third-quarter GDP growth will remain a touch above 3 percent.

Permits for nonresidential construction have risen markedly in recent months, and we expect that spending in this area will increase noticeably this quarter.

Housing activity should slip, however, owing to the effects of higher mortgage rates. Although the Michigan SRC consumer survey shows households' perceptions of homebuying conditions to be relatively favorable as of October, homebuilders and others report signs of weakening demand. We are projecting that single-family starts, which were 1.22 million units (annual rate) in the third quarter, will average 1.15 million units this quarter.

As for the remaining components of expenditure, we are expecting that real net exports will reverse a portion of the third-quarter decline. In the government sector, federal purchases are expected to turn back down, but this should be offset by another moderate increase in state and local purchases.

For inflation, we are projecting that the CPI excluding food and energy will rise at a 3-1/2 percent annual rate this quarter, or about 0.3 percent per month, which is slightly above the recent pace. The firming in prices is expected to be most noticeable for consumer goods; for these items, some modest price effects from strong demand, rising production costs, and higher import prices are anticipated to show through. Nonetheless, owing to favorable developments for food and energy prices, the overall CPI is expected to rise 3 percent.

The Outlook for the Economy in 1995 and 1996

Growth of real GDP is projected to slow sharply over the next three quarters, reflecting a slackening of the pace of both final sales and inventory investment. Owing to the higher level of real interest rates than previously assumed, economic growth does not return to a pace matching that of potential output until the latter part of 1996. The unemployment rate is projected to rise next year and to edge above the NAIRU in 1996; with goods output decelerating and capacity expanding a bit faster, the factory utilization rate is projected to drop appreciably by 1996. Although we are showing some acceleration in core inflation in the near term, the easing of pressure on productive resources is projected to return the trend in CPI inflation to about 3 percent in 1996.

STAFF REAL GDP PROJECTION
(Percent change, annual rate)

	1994		1995			
	Q3	Q4	Q1	Q2	H2	1996
Real GDP	3.4	4.1	2.5	1.4	1.2	2.2
Previous		2.8	1.9	1.7	1.9	2.3
Final sales	3.1	4.8	2.4	2.2	1.8	2.2
Previous		3.7	2.1	2.0	2.2	2.3
Real PCE	3.0	4.3	2.5	2.2	1.6	1.9
Previous		2.9	2.5	1.8	1.9	2.1

Substantial uncertainties attach to any forecast, and recent developments have underscored two key areas of concern as we attempt to gauge the cyclical forces in the economy. The first is the difficulty in assessing the extent and timing with which various sectors of final demand will respond to movements in interest rates; in the current instance, we need also to cope with an unusual pattern of financial developments in the period of monetary tightening, including a depreciating dollar and easing credit supplies. The second area of concern is the difficulty in judging how fast businesses will seek to gear down their accumulation of inventories; gauging desired levels of stocks is always a tricky affair. While we believe that a pattern of activity at least roughly along the lines we are describing is the most probable, we recognize that many other scenarios are possible: These range from a quicker softening in demand, which obviates further money market tightening and approximates the proverbial soft landing, to more persistent momentum in growth, which necessitates greater policy tightening than we have assumed and looks somewhat more like the traditional inflationary boom-bust cycle. At this point, we would view the probability distribution as skewed slightly toward the latter.

Inventory investment. The pace of inventory investment over the past two quarters--which has raised nonfarm stocks at around a 5 percent annual rate--is clearly unsustainable. Nonetheless, with firms now seemingly optimistic about sales prospects and reportedly more concerned about the availability or cost of supplies, we do not think that the rate of accumulation will drop precipitously. Certainly, auto dealers would like to operate with somewhat higher stocks, and, in other sectors, until capacity pressures ease some, a broad range of firms is likely to want some cushion--even while retaining longer-range plans for implementing more streamlined, just-in-time production and distribution systems.

Our forecast shows nonfarm inventory building running at about the current pace into early 1995. As final demand begins to decelerate perceptibly, the move to adjust orders and production probably will come fairly quickly. The sluggishness of sales will likely work against the immediate achievement of desired stock levels, however, and inventory investment is thus projected to be a significant negative contributor to GDP growth over the last three quarters of 1995 (to the tune of a bit more than 1/2 percentage point). In 1996, inventory investment is expected to be an essentially neutral factor in output growth.

Consumer spending. Beginning early in 1995, slower jobs gains and income growth, along with rising interest rates, are projected to generate a marked deceleration in consumer spending. The sharpest slowing occurs in the demand for durables. After rising 7-3/4 percent during 1994, real outlays on durables are projected to increase just over 1 percent, on average, in 1995 and then to grow moderately faster in 1996. We are forecasting that households will begin to forgo purchases of new motor vehicles early next year, with sales dipping below 15 million units (annual rate) by mid year; sales then firm a bit in 1996, to around a 15-1/4 million unit rate. Households are also anticipated to take a breather after the recent steep run-up in purchases of home goods; in addition to the influences of income and financing, the decline in housing activity is expected to result in slower spending on furniture and appliances. For nondurables and services--where spending tends to track trends in income more closely--the projected deceleration is more modest in 1995 than in the case of durables, and growth remains moderate in 1996.

The personal saving rate rises noticeably over the next two years. This pattern reflects the moderation of demands for durable goods after a period in which some pent-up demands were satisfied, as well as a response to the rise in real interest rates and in debt-service burdens.

Residential investment. We now expect that interest rates on fixed-rate mortgages will continue to edge up through early next year; although they are likely to drop back noticeably by 1996, rates are projected to remain higher in real terms than we had previously anticipated. Moreover, adjustable rate financing, which has recently been seen as an attractive alternative to fixed-rate loans, will become more costly as money market conditions tighten. Against that backdrop, we are expecting to see single-family housing starts decline considerably in the coming months, reaching a low of

1.05 million units (annual rate) in the third quarter of next year. After mortgage interest rates turn back down, homebuilding is anticipated to firm gradually, with single-family starts reaching 1.13 million units by the end of 1996. It is noteworthy, however, that even at the forecasted lows in 1995, single-family starts remain well above the pace of the early 1990s, when cash-flow affordability was less favorable.

In the multifamily sector, we have retained a very slight upward tilt to the projected level of starts over the next two years. Although the rental vacancy rate remains relatively high on a national basis, market conditions have improved sufficiently in some locales to support new construction. Financing is anticipated to remain available to qualified developers.

Business fixed investment. Owing to the recent strength in sales and profits, business investment will likely carry greater momentum into 1995 than we previously thought it would. However, given the less favorable financial environment and the sharper deceleration in economic activity that we now are projecting for next year, the slowing in capital spending over the course of 1995 is greater than in our previous projection. Real spending on business equipment is projected grow at a 12 percent annual rate in the first quarter of next year, but then is expected to drop to a 3-1/2 percent pace by year-end. As output growth picks up in 1996, demand for equipment should also begin to expand a bit faster. While the growth in equipment spending this year has been fairly broadly based, the growth during the next two years is anticipated to come almost entirely from a continued appreciable expansion of real computer purchases. Declining computer prices are likely to keep the user cost of such capital low even while interest rates substantially exceed the rate of general inflation.

Our projection of outlays for nonresidential structures remains roughly the same as in the previous Greenbook: Over the next year, we expect the expansion of industrial and commercial facilities to contribute importantly to an improved pace of outlays for nonresidential building; overall, real spending is projected to rise 6-1/2 percent during 1995. But with economic activity expanding only slowly, nonresidential construction is expected to slow again in 1996, rising only about 4 percent.

Net exports. The changes in the outlook for the dollar, for growth abroad, and for domestic demand have combined to move the forecasted contribution of real net exports more clearly in a positive direction. After having subtracted an estimated 2/3 percentage point from growth of real GDP in 1994, real net exports contribute marginally to growth in both 1995 and 1996. (A full discussion of this sector is contained in the International Developments section.)

Government purchases. The ongoing contraction in real federal government purchases was interrupted last quarter by a surge in defense outlays and a smaller uptick in nondefense spending. About $2 billion of our $7-1/2 billion "surprise" relative to the last Greenbook reflects military spending for operations in Haiti. A similar one-time expenditure is expected this quarter as a result of the military buildup in the Persian Gulf, and a small amount of additional spending for both operations will temper the decline in purchases in the first quarter of 1995. The remainder of last quarter's surprise is assumed to represent the bunching of deliveries that will spill over into this quarter as well. We expect that, after these transitory boosts to defense outlays are behind us, there will be a steep decline in federal purchases during the first half of 1995, moving the level of spending back on trend.

The contraction in defense outlays is then expected to taper off, with declines of 6-1/4 percent in the second half of next year and 4-1/2 percent in 1996. Nondefense purchases are projected to fall at just over a 1 percent rate, on average, during the projection period.

Real state and local government purchases are expected to rise at an annual rate of 2-1/2 percent during the next two years. This moderate growth path represents a balancing of rising pressures for public services and infrastructure improvements against voter preferences for tax reduction. We are forecasting a continued modest expansion of state and local employment and moderate growth in outlays for structures.

Labor markets. Growth in labor demand is expected to slow gradually in 1995, with the average workweek dropping back somewhat and monthly payroll employment gains receding to less than 100,000 during the second and third quarters. As a result, by year-end the unemployment rate is projected to move back up to 6.1 percent--our current point estimate of the NAIRU. With output growth still running shy of potential in 1996, employment growth should pick up only modestly and the unemployment rate is projected to drift up further to 6-1/4 percent. Uncertainties associated with the introduction of the new household survey continue to make interpretation of the labor force data especially difficult. We are assuming that, with a fairly tight labor market, the participation rate will rise gradually from here.

Businesses will likely act fairly promptly to reduce growth in their payrolls as production and sales decelerate. However, the pace of activity is expected to be sufficiently sluggish from mid- to late-1995 that firms will be unable to avoid a period in which labor productivity growth falls well short of its underlying, cyclically adjusted trend, which we estimate to be about 1.4 percent per annum. The growth of output per hour is projected to recede to less than 1 percent (annual rate) in the second half of next year. Assuming businesses will remain cautious as economic activity picks up in 1996, labor productivity is likely to accelerate somewhat.

STAFF LABOR MARKET PROJECTION[1]
(Percent change, at annual rates, except as noted)

	1994	1995		
	Q4	H1	H2	1996
Nonfarm payroll employment	2.4	1.5	.8	1.1
Previous	2.3	1.0	1.2	1.3
Output per hour, nonfarm business	-.1	1.6	.7	1.3
Previous	.7	1.1	1.0	1.4
Civilian unemployment rate [2]	5.7	5.8	6.1	6.3
Previous	6.0	6.2	6.3	6.3

1. Percent changes are from final quarter of previous period to final quarter of period indicated.
2. Average for final quarter of period.

Wages and prices. Because resource utilization currently is tighter than we previously anticipated, we are now forecasting a more noticeable upturn in wage and price inflation for early 1995.[2] With labor markets assumed to remain tight in the near term, the trend in ECI compensation is projected to accelerate from 3.3 percent over the twelve months ended in September to 3-3/4 percent by the middle of next year. In particular, wage increases are likely to break above the 3 percent trend that has been apparent in the ECI for the past several years; by the second quarter of 1995, the year-over-year change in ECI wages and salaries is projected to be about 3-1/2 percent. We are anticipating that trends in benefit costs will be little changed, with health

2. The projection incorporates the changes in CPI measurement that are discussed in the Appendix to the Nonfinancial Developments section of Part 2. All told, the effect of the changes is to lower CPI inflation by about 0.1 percentage point per year.

insurance cost increases remaining relatively moderate and pension fund contributions continuing to rise substantially.

STAFF INFLATION PROJECTION
(Percent change, annual rate)

	1994	1995			
	Q4	Q1	Q2	H2	1996
CPI	3.1	3.7	3.3	3.0	2.9
Previous	3.3	3.7	3.2	3.1	3.0
Excl. food and energy	3.5	3.8	3.6	3.2	3.1
Previous	3.6	3.5	3.2	3.2	3.1
ECI	3.6	3.8	3.8	3.7	3.6
Previous	2.7	3.6	3.6	3.6	3.5

The projected rise in the core CPI over the first half of 1995 is now 3-3/4 percent, which will boost the year-over-year change from 3 percent as of this September to 3-1/2 percent in mid-1995. The acceleration is expected to occur largely, if not entirely, in the goods component of the index. That pickup in inflation is expected to be the result of the combined influence of several factors, which overlap and whose effects cannot be readily separated: the pressures from higher costs of materials on the pricing of finished goods; the effect that the speed with which production and sales have firmed recently is expected to have on materials costs and price markups; and the direct and indirect effect of rising prices of non-oil imports. By the first quarter of 1995, the CPI for consumer goods (excluding food and energy) is projected to be rising at a 3-3/4 percent annual rate, up from less than a 2 percent rate over the first three quarters of this year.

The CPI for energy, which has fluctuated widely in recent quarters, is anticipated to swing up sharply again in the first quarter of 1995. In particular, higher prices of crude oil and the switch to reformulated gasoline should lead to a substantial rise in retail prices of petroleum products. Energy prices are expected to rise relatively moderately thereafter, restrained by the assumed stability in world oil prices. Food prices are projected to rise at a moderate rate throughout the projection.

In the second half of 1995, we expect that the impetus to inflation from tight resource utilization will have begun to ease; a small output gap is assumed to open in 1996. Thus, we expect that an unwinding of "speed effects" along with the emergence of a small margin of slack will slow the core CPI noticeably. At the same time, a stable dollar should reduce the rate of increase in prices of imported goods to a pace below that of domestic goods. All told, by 1996, the trend in the core CPI is projected to be back down to just over 3 percent. Because of the moderate pace of food and energy prices, overall CPI inflation is projected to run a shade below the core rate.

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

Interval	Nominal GDP 09/21/94	Nominal GDP 11/09/94	Real GDP 09/21/94	Real GDP 11/09/94	GDP fixed-weight price index 09/21/94	GDP fixed-weight price index 11/09/94	Consumer price index[1] 09/21/94	Consumer price index[1] 11/09/94	Unemployment rate (level except as noted) 09/21/94	Unemployment rate (level except as noted) 11/09/94
ANNUAL										
1992[2]	5.2	5.2	2.3	2.3	3.2	3.2	3.0	3.0	7.4	7.4
1993[2]	5.4	5.4	3.1	3.1	3.0	3.0	3.0	3.0	6.8	6.8
1994	5.9	6.1	3.8	3.9	2.7	2.7	2.7	2.6	6.2	6.1
1995	4.9	5.1	2.3	2.5	3.1	3.1	3.4	3.3	6.2	5.9
1996	4.5	4.3	2.1	1.8	2.9	2.9	3.0	3.0	6.3	6.2
QUARTERLY										
1993 Q1[2]	4.4	4.4	1.2	1.2	4.2	4.2	2.8	2.8	7.0	7.0
Q2[2]	4.2	4.2	2.4	2.4	2.4	2.4	3.1	3.1	7.0	7.0
Q3[2]	3.8	3.8	2.7	2.7	2.0	2.0	2.0	2.0	6.7	6.7
Q4[2]	7.7	7.7	6.3	6.3	2.4	2.4	3.1	3.1	6.5	6.5
1994 Q1[2]	6.1	6.1	3.3	3.3	3.1	3.1	1.9	1.9	6.6	6.6
Q2[2]	6.9	7.2	3.8	4.1	2.9	2.9	2.8	2.8	6.2	6.2
Q3[2]	4.8	5.2	3.0	3.4	2.6	2.7	3.8	3.6	6.1	6.0
Q4	5.6	6.1	2.8	4.1	3.2	3.0	3.3	3.1	6.0	5.7
1995 Q1	4.9	5.7	1.9	2.5	3.5	3.7	3.7	3.7	6.1	5.7
Q2	4.0	4.2	1.7	1.4	2.8	3.1	3.2	3.3	6.2	5.8
Q3	4.3	3.6	1.8	1.0	2.8	2.9	3.1	3.1	6.2	6.0
Q4	4.4	3.8	2.0	1.5	2.8	2.8	3.0	2.9	6.3	6.1
1996 Q1	4.8	4.5	2.2	1.8	3.2	3.1	3.0	2.9	6.3	6.2
Q2	4.7	4.6	2.3	2.2	2.8	2.8	3.0	2.9	6.3	6.2
Q3	4.6	4.7	2.3	2.3	2.8	2.9	3.0	2.9	6.3	6.2
Q4	4.6	4.8	2.3	2.4	2.8	2.9	3.0	2.9	6.3	6.3
TWO-QUARTER[3]										
1993 Q2[2]	4.3	4.3	1.8	1.8	3.3	3.3	3.1	3.1	-.3	-.3
Q4[2]	5.7	5.7	4.5	4.5	2.2	2.2	2.4	2.4	-.5	-.5
1994 Q2[2]	6.5	6.6	3.6	3.7	3.0	3.0	2.4	2.4	-.3	-.3
Q4	5.2	5.7	2.9	3.8	2.9	2.8	3.6	3.3	-.2	-.5
1995 Q2	4.4	4.9	1.8	1.9	3.2	3.4	3.4	3.5	.2	.1
Q4	4.3	3.7	1.9	1.2	2.8	2.9	3.0	3.0	.1	.3
1996 Q2	4.7	4.6	2.3	2.0	3.0	3.0	3.0	2.9	.0	.1
Q4	4.6	4.8	2.3	2.4	2.8	2.9	3.0	2.9	.0	.1
FOUR-QUARTER[4]										
1992 Q4[2]	6.4	6.4	3.7	3.7	3.2	3.2	3.1	3.1	.3	.3
1993 Q4[2]	5.0	5.0	3.1	3.1	2.8	2.8	2.7	2.7	-.8	-.8
1994 Q4	5.9	6.2	3.3	3.8	3.0	2.9	3.0	2.9	-.5	-.8
1995 Q4	4.4	4.3	1.8	1.5	3.0	3.1	3.2	3.3	.3	.4
1996 Q4	4.7	4.7	2.3	2.2	2.9	2.9	3.0	2.9	.0	.2

1. For all urban consumers.
2. Actual.
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.

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

November 9, 1994

Item	Unit[1]	1988	1989	1990	1991	1992	1993	Projected 1994	1995	1996
EXPENDITURES										
Nominal GDP	Bill $	4900.4	5250.8	5546.1	5724.8	6020.2	6343.3	6729.4	7074.3	7379.9
Real GDP	Bill 87$	4718.6	4838.0	4897.3	4867.6	4979.3	5134.5	5337.1	5471.8	5570.5
Real GDP	% change	3.3	1.6	2	3	3.7	3.1	3.8	1.5	2.2
Gross domestic purchases		2.5	9	-.4	-.1	4.1	3.9	4.3	1.4	2.1
Final sales		4.2	1.5	1.2	-.4	3.8	3.0	2.9	2.1	2.2
Private dom. final purch		4.2	5	-.1	-.8	5.1	5.0	4.2	2.4	2.4
Personal cons. expend		4.2	1.2	7	0	4.2	3.0	3.3	1.9	1.9
Durables		8.5	-.5	-.8	-1.3	9.6	9.0	7.6	1.1	2.3
Nondurables		3.2	1.2	-.1	-1.6	3.2	1.3	2.7	1.6	1.5
Services		3.7	1.7	1.7	1.2	3.5	2.5	2.5	2.4	2.1
Business fixed invest.		5.5	-.4	7	-6.2	6.7	16.0	10.3	7.0	4.3
Producers' dur. equip.		9.1	-1.7	2.9	-3.2	11.0	21.3	12.9	7.1	4.4
Nonres. structures		-1.2	2.3	-3.9	-12.4	-3.4	1.6	2.1	6.5	3.9
Res. structures		9	-7.7	-15.2	7	17.0	8.1	1.1	-4.9	3.0
Exports		13.5	11.3	6.7	8.1	5.0	5.8	8.3	8.6	9.1
Imports		3.6	2.6	.4	4.0	8.6	12.4	11.9	6.2	7.2
Government purchases		2	2.0	3.3	-.8	7	-1.0	-.1	-.7	5
Federal		-3.4	-.6	2.8	-3.2	.8	-6.9	-3.4	-6.3	-3.2
Defense		-3.2	-1.5	1.5	-7.0	-1.3	-9.0	-4.5	-8.8	-4.5
State and local		2.9	4.0	3.6	8	.6	3.0	1.9	2.5	2.5
Change in bus. invent.	Bill 87$	19.9	29.8	5.7	-1.1	2.5	15.3	51.5	43.0	28.4
Nonfarm		26.9	29.9	3.2	-1.3	-2.0	18.5	44.3	39.4	26.1
Net exports		-104.0	-73.7	-54.7	-19.5	-32.3	-73.9	-112.1	-110.3	-100.6
Nominal GDP	% change	7.7	6.0	4.7	3.5	6.4	5.0	6.2	4.3	4.7
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employ	Millions	105.2	107.9	109.4	108.3	108.6	110.5	113.4	115.5	116.7
Unemployment rate	%	5.5	5.3	5.5	6.7	7.4	6.8	6.1	5.9	6.2
Industrial prod. index	% change	3.2	-.1	-.2	-.3	3.2	4.2	6.4	1.9	2.6
Capacity util. rate-mfg	%	83.6	83.1	81.1	77.8	78.6	80.6	83.7	84.4	83.4
Housing starts	Millions	1.49	1.38	1.19	1.01	1.20	1.29	1.42	1.35	1.41
Light Motor Vehicle Sales		15.43	14.53	13.85	12.31	12.80	13.89	15.10	15.13	15.25
Auto sales in U.S.		10.63	9.91	9.50	8.39	8.35	8.72	9.24	9.17	9.28
North American prod.		7.54	7.08	6.90	6.14	6.26	6.75	7.25	7.34	7.53
Other		3.10	2.83	2.60	2.25	2.10	1.97	1.99	1.83	1.75
INCOME AND SAVING										
Nominal GNP	Bill $	4908.2	5266.8	5567.8	5740.8	6025.8	6347.8	6722.1	7050.1	7347.7
Nominal GNP	% change	7.8	6.1	4.9	3.2	6.1	5.0	6.0	4.1	4.6
Nominal personal income		7.1	6.5	6.5	3.7	8.1	2.8	6.6	5.4	5.2
Real disposable income		3.2	1.1	1.1	9	5.0	5	3.8	2.0	2.2
Personal saving rate	%	4.4	4.0	4.2	5.0	5.5	4.1	4.0	4.2	4.6
Corp. profits, IVA&CCAdj	% change	10.2	-6.3	2.3	8.8	9.6	23.4	3.9	-3.1	6.0
Profit share of GNP	%	7.4	6.9	6.8	6.8	6.7	7.7	8.1	7.8	7.6
Federal surpl./def.	Bill. $	-136.6	-122.3	-163.5	-202.9	-282.7	-241.4	-162.8	-162.8	-189.5
State/local surpl./def.		38.4	44.8	25.1	17.0	24.8	26.3	26.8	29.2	32.5
Ex. social ins. funds		-18.4	-17.5	-35.6	-46.5	-41.6	-40.0	-38.8	-35.3	-31.6
PRICES AND COSTS										
GDP implicit deflator	% change	4.2	4.4	4.5	3.3	2.6	1.8	2.4	2.7	2.4
GDP fixed-wt. price index		4.2	4.4	4.6	3.6	3.2	2.8	2.9	3.1	2.9
Gross domestic purchases fixed-wt. price index		4.1	4.4	5.2	2.9	3.2	2.5	3.0	3.1	2.8
CPI		4.3	4.6	6.3	3.0	3.1	2.7	2.9	3.3	2.9
Ex. food and energy		4.5	4.4	5.3	4.4	3.5	3.1	3.1	3.4	3.1
ECI, hourly compensation[2]		4.8	4.8	4.6	4.4	3.5	3.6	3.3	3.7	3.6
Nonfarm business sector										
Output per hour		5	-1.4	.4	2.3	3.2	1.8	8	1.2	1.3
Compensation per hour		3.8	3.1	6.2	4.7	5.1	2.4	3.3	3.8	3.7
Unit labor cost		3.3	4.6	5.7	2.3	1.9	.6	2.5	2.6	2.4

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

Strictly Confidential (FR)
Class II FOMC

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

November 9 1994

Item	Unit	1992 Q1	1992 Q2	1992 Q3	1992 Q4	1993 Q1	1993 Q2	1993 Q3	1993 Q4	1994 Q1	1994 Q2
_XPENDITURES											
Nominal GDP	Bill $	5896 8	5971.3	6043 6	6169 3	6235 9	6299 9	6359 2	6478.1	6574 7	6689 9
Real GDP	Bill 87$	4918 5	4947 5	4990.5	5060 7	5075.3	5105.4	5139.4	5218.0	5261 1	5314 1
Real GDP	% change	3.1	2.4	3.5	5 7	1 2	2.4	2.7	6.3	3 3	4 1
Gross domestic purchases		3.2	3.7	3 9	5 7	2.7	3.3	4 0	5.8	5.0	4 6
Final sales		4 8	1.5	3 5	5 6	2	2.4	3.2	6.4	2.2	1 5
Private dom. final purch.		5 7	4 2	3 9	6 7	3 5	3.7	5.3	7.4	5.8	2 7
Personal cons expend.		5 8	1 7	3 9	5.6	1.6	2.6	3.9	4.0	4 7	1.3
Durables		15.5	4	10 0	13.2	3.2	9 8	7 7	15.5	8 8	.4
Nondurables		4 2	- 7	2.7	6.9	-1.6	1.6	2.8	2.4	3 8	2.2
Services		4 5	3 4	3 2	3.0	3 1	1.4	3 6	2.0	4 0	1 1
Business fixed invest.		- 1	15 0	5.0	7.5	15.1	15 6	12 2	21 1	10 9	9.2
Producers' dur equip.		-1.3	22 7	11.0	12 9	20 0	21 6	16 2	27 5	18 6	6 1
Nonres structures		2.9	-1 6	-8 9	-5 5	2 5	3	5	3 3	-11 8	20.6
Res structures		22.4	22 7	8	23 8	5 3	-7 6	9 4	28 2	10 0	7.0
Exports		6.1	1.5	5.3	7 2	-1 0	7 7	-3 2	21.7	-3 5	16.6
Imports		6.6	13 0	8.4	6 5	11 6	14 9	7 4	16.0	9 5	18 9
Government purchases		1.5	-3 0	3.4	9	-5 9	1.2	1.1	- 1	-4 9	-1.2
Federal		-1.3	-4 8	8.6	1.1	-15.4	-3.6	-3 0	-5.0	-10 3	-7 9
Defense		-7.2	-5 1	11.5	-3.3	-20 0	-2.2	-9 2	-3.6	-16 0	-4 1
State and local		3.3	-1.8	.1	.8	.9	4.4	3.7	2.9	-1.4	2.9
Change in bus. invent.	Bill 87$	-6 3	4 2	5 2	6.6	18.5	18.9	13 0	10 8	25 4	59 2
Nonfarm		-14 3	-1.9	1 8	6.3	19.7	22.8	20.9	10.7	22.1	51 7
Net exports		-17 9	-34 1	-38 9	-38.5	-57 6	-69.3	-86.3	-82.2	-104.0	-111 8
Nominal GDP	% change	7 1	5 2	4 9	8 6	4 4	4 2	3 8	7 7	6 1	7 2
_MPLOYMENT AND PRODUCTION											
_onfarm payroll employ	Millions	108.1	108.4	108.7	109 1	109.7	110 3	110 8	111.4	112.0	113 0
Unemployment rate[1]	%	7 3	7.5	7.5	7 3	7 0	7.0	6.7	6 5	6.6	6 2
Industrial prod. index	% change	.3	5.6	6	6 4	5 2	2.3	2.8	6 7	8.3	5.4
Capacity util rate-mfg [1]	%	77 9	78.7	78.5	79.4	80.1	80.3	80 3	81.5	82 5	83 3
Housing starts	Millions	1 24	1.15	1.19	1.24	1.15	1.24	1 31	1.48	1.37	1.44
Light Motor Vehicle Sales		12.46	12.81	12.71	13.22	13 23	14.11	13.69	14 53	15.45	14 75
Auto sales in U.S		8.33	8 41	8 24	8.43	8.32	8.93	8.65	8.97	9 45	9 15
North American prod.		6.12	6.25	6.25	6.40	6.36	6.87	6.68	7.08	7 44	7 16
Other		2.21	2 16	1.99	2.03	1.96	2.07	1.97	1.89	2.00	1.99
INCOME AND SAVING											
Nominal GNP	Bill. $	5907.7	5979.1	6049.4	6167 0	6243.9	6303 3	6367 8	6476 2	6574 0	6682 5
Nominal GNP	% change	6.8	4.9	4.8	8.0	5.1	3.9	4 2	7 0	6.2	6 8
Nominal personal income		8.2	5.6	3.7	15 3	-5.8	8.6	2.4	6 7	5.3	7 7
Real disposable income		5.9	2.1	1.7	10.6	-7.4	4.7	8	4 3	3.4	3.5
Personal saving rate[1]	%	5.3	5.5	5.0	6.2	4.0	4 6	3.9	4.0	3.6	4.1
Corp. profits, IVA&CCAdj	% change	18.8	5	-40.0	101.1	9.6	30.7	18.4	37.0	-17 9	33 6
Profit share of GNP[1]	%	7 0	6 9	6.0	7.0	7.1	7.5	7.7	8 2	7.7	8.2
Federal govt. surpl./def	Bill $	-279.9	-284.8	-293 9	-272.1	-283 5	-237 0	-224.9	-220.1	-176 2	-145.1
State/local surpl./def		19 9	25.9	20.4	33.1	21 6	25.3	23 9	34 5	25 2	27 0
Ex social ins funds		-45.7	-40.5	-46 3	-33.8	-44.7	-41.1	-42.4	-31.7	-40 7	-38.9
PRICES AND COSTS											
GDP implicit deflator	% change	3 8	2 7	1.3	2 7	3.3	1.6	1.0	1.3	2.9	2.9
GDP fixed-wt. price index		3.9	3 3	2.7	2.8	4.2	2.4	2.0	2.4	3.1	2 9
Gross domestic purchases fixed-wt price index		3.6	3 4	3.2	2.5	3 3	2.6	1.6	2.4	2.5	3.2
CPI		2.6	3.5	2.9	3 5	2.8	3.1	2.0	3.1	1 9	2.8
Ex. food and energy		3.7	3 6	3.0	3 6	3 5	3.5	2 4	2.9	2 6	3.4
_CI, hourly compensation[2]		3.6	3.2	3.2	3.5	3 9	3.8	3.4	3.4	2 7	3 7
_onfarm business sector											
Output per hour		4.2	1 9	2.8	3.8	-2 0	.4	4 0	4 9	2 9	-2.1
Compensation per hour		5.7	4 6	5.8	4.5	2.1	2.4	2.8	2.4	6 1	7
Unit labor cost		1.4	2.6	2 9	6	4.1	2.0	-1.2	-2.4	3 1	2.9

1 Not at an annual rate   2. Private-industry workers.

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

November 9, 1994

Item	Units	1994 Q3	1994 Q4	Projected 1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4
EXPENDITURES											
Nominal GDP	Bill. $	6775.9	6876.9	6972.1	7044.2	7106.8	7174.2	7253.6	7335.9	7421.1	7509.0
Real GDP	Bill. 87$	5359.2	5413.8	5446.7	5465.0	5477.9	5497.7	5522.8	5553.5	5585.9	5619.7
Real GDP	% change	3.4	4.1	2.5	1.4	1.0	1.5	1.8	2.2	2.3	2.4
Gross domestic purchases		3.9	3.8	2.4	1.2	.7	1.2	1.6	2.0	2.2	2.4
Final sales		3.1	4.8	2.4	2.2	1.7	1.9	2.2	2.3	2.2	2.3
Private dom. final purch.		3.0	5.3	3.2	2.6	1.7	1.9	2.2	2.3	2.4	2.5
Personal cons. expend.		3.0	4.3	2.5	2.2	1.4	1.7	1.8	1.9	2.0	2.1
Durables		7.9	13.7	2.0	2.1	-1.7	2.0	2.2	2.2	2.2	2.5
Nondurables		2.1	2.7	2.1	1.5	1.5	1.3	1.4	1.5	1.5	1.5
Services		2.1	2.7	2.8	2.7	2.2	2.0	2.0	2.0	2.2	2.3
Business fixed invest.		7.0	14.2	10.9	8.1	5.3	3.9	4.1	4.2	4.4	4.6
Producers' dur. equip.		11.0	16.1	11.8	8.5	5.0	3.4	4.1	4.3	4.5	4.8
Nonres. structures		-5.4	8.1	7.5	6.4	6.3	5.8	4.0	3.9	3.9	3.9
Res. structures		-7.2	-4.4	-6.6	-7.2	-4.2	-1.2	3.0	3.8	2.8	2.5
Exports		9.8	11.4	9.0	9.0	8.2	8.1	8.8	9.2	9.1	9.2
Imports		12.1	7.5	7.5	6.8	5.4	5.3	6.5	6.6	7.6	8.2
Government purchases		5.9	.2	-1.8	-1.0	-.1	.2	.4	.3	.5	.9
Federal		9.8	-4.1	-9.0	-7.1	-4.8	-4.2	-3.6	-3.9	-3.2	-2.3
Defense		8.6	-4.8	-12.5	-10.1	-6.7	-5.7	-4.7	-5.3	-4.3	-3.7
State and local		3.8	2.7	2.5	2.5	2.5	2.6	2.5	2.4	2.4	2.5
Change in bus. invent.	Bill. 87$	64.5	57.0	57.3	46.7	37.3	30.8	26.6	26.7	28.9	31.5
Nonfarm		56.0	47.5	50.8	43.2	35.3	28.5	24.3	24.4	26.5	29.1
Net exports		-118.3	-114.4	-114.1	-112.4	-109.1	-105.7	-103.3	-100.2	-99.3	-99.4
Nominal GDP	% change	5.2	6.1	5.7	4.2	3.6	3.8	4.5	4.6	4.7	4.8
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employ.	Millions	113.9	114.6	115.2	115.5	115.6	115.9	116.2	116.5	116.9	117.2
Unemployment rate[1]	%	6.0	5.7	5.7	5.8	6.0	6.1	6.2	6.2	6.2	6.3
Industrial prod. index	% change	6.0	5.8	3.7	1.9	.9	1.2	1.9	2.6	2.8	3.0
Capacity util. rate-mfg[1]	%	84.1	84.9	85.0	84.7	84.2	83.8	83.5	83.4	83.4	83.4
Housing starts	Millions	1.48	1.41	1.37	1.34	1.33	1.35	1.38	1.40	1.42	1.43
Light Motor Vehicle Sales		14.64	15.55	15.34	15.30	14.89	14.99	15.13	15.21	15.29	15.37
Auto sales in U.S.		9.09	9.27	9.30	9.30	9.00	9.08	9.20	9.25	9.30	9.35
North American prod.		7.09	7.31	7.30	7.40	7.30	7.35	7.45	7.50	7.55	7.60
Other		2.01	1.97	2.00	1.90	1.70	1.73	1.75	1.75	1.75	1.75
INCOME AND SAVING											
Nominal GNP	Bill. $	6768.9	6862.8	6955.8	7018.8	7082.4	7143.4	7223.0	7302.1	7391.6	7473.9
Nominal GNP	% change	5.3	5.7	5.5	3.7	3.7	3.5	4.5	4.5	5.0	4.5
Nominal personal income		4.9	8.6	6.8	4.9	4.1	5.8	6.1	4.8	4.3	5.6
Real disposable income		2.7	5.8	2.2	.9	1.7	3.1	3.3	1.0	1.9	2.6
Personal saving rate[1]	%	4.0	4.3	4.3	4.0	4.1	4.4	4.7	4.5	4.5	4.6
Corp. profits, IVA&CCAdj	% change	6.7	-.5	.4	-5.9	.3	-7.1	2.8	4.8	11.1	5.5
Profit share of GNP[1]	%	8.2	8.1	8.0	7.8	7.7	7.5	7.5	7.5	7.6	7.6
Federal govt. surpl./def.	Bill. $	-154.3	-175.6	-160.1	-152.2	-155.7	-183.1	-194.2	-182.0	-180.7	-201.0
State/local surpl./def.		26.5	28.5	30.1	30.1	28.8	27.7	29.0	30.4	34.4	36.0
Ex. social ins. funds		-38.8	-36.7	-34.8	-34.5	-35.5	-36.5	-35.1	-33.6	-29.6	-28.0
PRICES AND COSTS											
GDP implicit deflator	% change	1.6	2.0	3.1	2.8	2.6	2.4	2.6	2.3	2.3	2.3
GDP fixed-wt. price index		2.7	3.0	3.7	3.1	2.9	2.8	3.1	2.8	2.9	2.9
Gross domestic purchases fixed-wt. price index		3.2	3.2	3.8	3.1	2.9	2.7	3.1	2.7	2.8	2.8
CPI		3.6	3.1	3.7	3.3	3.1	2.9	2.9	2.9	2.9	2.9
Ex. food and energy		2.8	3.5	3.8	3.6	3.2	3.1	3.1	3.1	3.1	3.1
ECI, hourly compensation[2]		3.3	3.6	3.8	3.8	3.7	3.7	3.7	3.7	3.6	3.6
Nonfarm business sector											
Output per hour		2.7	-.1	2.0	1.3	.7	.7	1.1	1.3	1.4	1.4
Compensation per hour		2.9	3.8	4.1	3.8	3.7	3.7	4.0	3.7	3.6	3.6
Unit labor cost		.1	3.9	2.1	2.5	3.0	3.0	2.8	2.3	2.1	2.1

1. Not at an annual rate. 2. Private-industry workers.

Strictly Confidential (FR)
Class II FOMC

NET CHANGES IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS[1]
(Billions of 1987 dollars)

November 9, 1994

Item	1992 Q1	1992 Q2	1992 Q3	1992 Q4	1993 Q1	1993 Q2	1993 Q3	1993 Q4	1994 Q1	1994 Q2	1991	1992	1993	Projected 1994
Real GDP	37.7	29.0	43.0	70.2	14.6	30.1	34.0	78.6	43.1	53.0	13.6	179.9	157.3	195.8
Gross domestic purchases	38.8	45.1	47.9	69.8	33.7	41.8	51.1	74.4	64.9	60.7	-6.4	201.6	201.0	228.1
Final sales	57.5	18.4	42.1	68.8	2.7	29.7	40.0	80.7	28.5	19.2	-20.7	186.8	153.1	149.6
Private dom. final purch.	55.1	41.7	39.1	66.3	35.9	38.6	54.5	76.9	61.9	29.8	-32.6	202.2	205.9	182.7
Personal cons. expend.	46.1	14.0	32.2	45.8	13.8	22.0	33.0	34.0	40.1	11.5	-.6	138.1	102.8	115.6
Durables	15.7	.4	10.7	14.3	3.7	11.2	9.0	18.1	10.9	.5	-5.5	41.1	42.0	38.8
Nondurables	10.7	-1.8	7.1	17.8	-4.2	4.3	7.4	6.3	10.3	6.0	-17.1	33.8	13.8	29.6
Services	19.7	15.3	14.4	13.7	14.4	6.4	16.6	9.6	18.9	5.1	22.1	63.1	47.0	47.2
Business fixed invest.	-.1	18.0	6.4	9.7	19.4	20.7	16.9	29.3	16.4	14.3	-33.3	34.0	86.3	64.6
Producers' dur. equip.	-1.2	18.6	9.9	11.8	18.4	20.7	16.6	28.2	20.9	7.5	-11.9	39.1	83.9	61.5
Nonres. structures	1.1	-.6	-3.5	-2.1	.9	.1	.2	1.2	-4.6	6.9	-21.4	-5.1	2.4	3.1
Res structures	9.2	9.8	.4	10.8	2.7	-4.1	4.7	13.5	5.4	3.9	1.2	30.2	16.8	2.4
Change in bus. invent.	-19.8	10.5	1.0	1.4	11.9	.4	-5.9	-2.2	14.6	33.8	34.4	-6.9	4.2	46.2
Nonfarm	-28.9	12.4	3.7	4.5	13.4	3.1	-1.9	-10.2	11.4	29.6	33.3	-8.3	4.4	36.8
Farm	9.1	-1.8	-2.8	-3.1	-1.5	-2.7	-4.0	8.0	3.2	4.2	1.0	1.4	-.2	9.4
Net exports	-1.0	-16.2	-4.8	.4	-19.1	-11.7	-17.0	4.1	-21.8	-7.8	19.9	-21.6	43.7	-32.2
Exports	8.4	2.1	7.4	10.2	-1.5	11.0	-4.9	29.9	-5.6	24.3	42.2	28.1	34.5	52.0
Imports	9.4	18.3	12.3	9.9	17.5	22.8	12.0	25.8	16.2	32.0	22.2	49.9	78.1	84.2
Government purchases	3.4	-7.1	7.8	2.1	-14.1	2.8	2.5	-.3	-11.6	-2.8	-8.0	6.2	-9.1	-.8
Federal	-1.2	-4.6	7.7	1.0	-15.4	-3.3	-2.7	-4.5	-9.4	-7.0	-12.4	2.9	-25.9	-12.1
Defense	-4.9	-3.4	7.1	-2.2	-14.2	-1.4	-5.9	-2.2	-10.2	-2.4	-19.9	-3.4	-23.7	-10.7
Nondefense	3.8	-1.2	.6	3.2	-1.3	-1.8	3.2	-2.3	.8	-4.5	7.4	6.4	-2.2	-1.4
State and local	4.5	-2.5	.1	1.1	1.3	6.1	5.2	4.2	-2.1	4.1	4.6	3.2	16.8	11.3

1. Annual changes are from Q4 to Q4

Strictly Confidential (FR)
Class II FOMC

NET CHANGES IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS[1]
(Billions of 1987 dollars)

November 9, 1994

			Projected											
	1994		1995				1996					Projected		
Item	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1993	1994	1995	1996
Real GDP	45.1	54.6	32.9	18.3	12.9	19.8	25.1	30.8	32.3	33.8	157.3	195.8	83.9	122.0
Gross domestic purchases	51.7	50.8	32.5	16.6	9.7	16.3	22.7	27.7	31.4	33.9	201.0	228.1	75.1	115.7
Final sales	39.8	62.1	32.5	29.0	22.3	26.3	29.2	30.7	30.1	31.3	153.1	149.6	110.1	121.2
Private dom. final purch.	33.1	57.9	36.3	29.6	19.4	22.3	25.9	27.0	28.0	29.4	205.9	182.7	107.7	110.3
Personal cons. expend.	26.1	37.9	22.1	19.8	12.4	16.0	16.8	17.2	18.3	19.3	102.8	115.6	70.3	71.7
Durables	10.0	17.4	2.8	2.8	-2.4	2.8	3.1	3.0	3.1	3.5	42.0	38.8	6.0	12.6
Nondurables	5.8	7.5	5.9	4.1	4.2	3.5	3.8	4.2	4.3	4.3	13.8	29.6	17.7	16.6
Services	10.2	13.0	13.4	12.9	10.6	9.6	9.9	10.0	11.0	11.6	47.0	47.2	46.6	42.5
Business fixed invest	11.3	22.6	18.1	13.9	9.4	7.0	7.5	7.8	8.1	8.6	86.3	64.6	48.4	32.0
Producers' dur. equip.	13.4	19.7	15.3	11.5	7.0	4.8	5.9	6.2	6.5	7.0	83.9	61.5	38.6	25.6
Nonres structures	-2.1	2.9	2.8	2.4	2.4	2.3	1.6	1.6	1.6	1.6	2.4	3.1	9.9	6.3
Res. structures	-4.3	-3.6	-3.9	-4.1	-2.4	-.7	1.6	2.1	1.5	1.4	16.8	2.4	-11.0	6.6
Change in bus invent	5.3	-7.5	4	-10.7	-9.4	-6.5	-4.1	1	2.3	2.5	4.2	46.2	-26.2	7
Nonfarm	4.3	-8.5	3.4	-7.7	-7.9	-6.8	-4.1	1	2.2	2.5	4.4	36.8	-19.0	6
Farm	1.0	1.0	-3.0	-3.0	-1.5	3	0	.0	1	0	-2	9.4	-7.2	1
Net exports	-6.5	3.9	4	1.7	3.2	3.4	2.4	3.0	9	-1	-43.7	-32.2	8.8	6.3
Exports	15.3	18.0	14.7	15.1	14.0	14.1	15.7	16.8	16.9	17.4	34.5	52.0	58.0	66.9
Imports	21.9	14.1	14.4	13.4	10.8	10.7	13.3	13.7	16.0	17.6	78.1	84.2	49.3	60.6
Government purchases	13.2	4	-4.2	-2.3	-3	5	9	6	1.2	2.0	-9.1	-8	-6.3	4.7
Federal	7.9	-3.6	-7.9	-6.0	-4.0	-3.4	-2.9	-3.1	-2.5	-1.8	-25.9	-12.1	-21.3	-10.3
Defense	4.7	-2.8	-7.5	-5.8	-3.7	-3.1	-2.5	-2.8	-2.2	-1.9	-23.7	-10.7	-20.1	-9.4
Nondefense	3.0	-7	-.4	-.2	-3	-3	-4	-3	-3	1	-2.2	-1.4	-1.2	-9
State and local	5.4	3.9	3.7	3.7	3.7	3.9	3.8	3.7	3.7	3.8	16.8	11.3	15.0	15.0

1 Annual changes are from Q4 to Q4.

STAFF PROJECTIONS OF FEDER. .ECTOR ACCOUNTS AND RELATED ITEMS
(Billions of dollars except as noted)

November 9, 1994

Item	Fiscal year				1994				1995				1996			
	1993[a]	1994[a]	1995	1996	Q1[a]	Q2[a]	Q3[b]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1153	1257	1342	1407	289	363	318	304	294	411	333	317	302	435	352	325
Outlays[1]	1409	1461	1530	1612	348	363	372	380	391	376	384	402	407	403	400	424
Surplus/deficit[1]	-255	-203	-188	-205	-59	0	-53	-75	-97	35	-50	-84	-105	33	-48	99
On-budget	-301	-259	-252	-267	-66	-33	-55	-83	-107	-5	-57	-90	-113	-7	-57	-103
Off-budget	46	56	64	63	8	33	2	8	9	40	7	6	9	39	9	5
Surplus excluding deposit insurance[2]	-283	-210	-205	-217	-65	3	-57	-78	-103	32	-56	-86	-109	31	-53	98
Means of financing																
Borrowing	249	185	202	212	51	8	37	61	86	11	44	66	88	15	43	69
Cash decrease	6	17	-24	0	5	-6	15	8	13	-45	0	25	20	-45	0	25
Other[3]	0	1	11	-8	2	-2	1	7	-1	-1	6	-7	-3	-3	5	5
Cash operating balance, end of period	53	36	60	60	45	51	36	28	15	60	60	35	15	60	60	35
NIPA FEDERAL SECTOR					Seasonally adjusted, annual rate											
Receipts	1242	1355	1451	1514	1338	1381	1388	1414	1449	1470	1473	1483	1501	1530	1542	1561
Expenditures	1497	1529	1612	1699	1514	1526	1543	1589	1609	1622	1629	1666	1696	1712	1722	1762
Purchases	447	439	437	429	438	435	443	443	441	434	431	429	431	429	428	427
Defense	307	295	290	280	292	292	298	297	293	287	284	281	282	279	278	277
Nondefense	140	144	147	149	146	144	145	146	148	147	148	148	150	150	150	151
Other expenditures	1049	1090	1175	1270	1076	1091	1100	1147	1168	1187	1198	1237	1265	1283	1295	1335
Surplus/deficit	-254	-174	-161	-185	-176	-145	-154	-175	-160	-152	-156	-183	-194	-182	-181	201
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-210	-163	-176	-182	-158	-141	-159	-192	-179	-168	-164	-186	-190	-176	-174	-194
Change in HEB, percent of potential GDP	- 1	- 7	2	.1	- 6	- 3	3	5	- 2	- 2	- 1	3	1	- 2	0	3
Fiscal impetus (FI), percent, cal year	-4 1	-6 9	-6 1	-5	-4 2	-4.3	3 1	-1 6	-3.1	-2 5	- 5	- 8	-2 3	-1 7	1	- 4

1 Excluding health reform, OMB's July 1994 deficit estimates are $220 billion in FY94, $167 billion in FY95, and $179 billion in FY96 CBO's August 1994 deficit estimates of the budget are $202 billion in FY94, $162 billion in FY95, and $176 billion in FY96 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 July 1994 deficit estimates, excluding deposit insurance spending, are $224 billion in FY94, $185 billion in FY95, and $187 billion in FY96 CBO's August 1994 deficit estimates, excluding deposit insurance spending, are $207 billion in FY94, $180 billion in FY95, and $188 billion in FY96

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 measure in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output generated by 2 3 percent real growth and an associated unemployment rate of 6 percent. Quarterly figures for change in HEB and FI are not at annual rates Change in HEB, as a percent of nominal potential GDP, is reversed in sign FI is the weighted difference of discretionary changes in federal spending and taxes (in 1987 dollars), scaled by real federal purchases For change in HEB and FI, negative values indicate restraint

a--Actual
b--Preliminary

Recent Developments

Since the September FOMC meeting, market interest rates have moved up appreciably--as much as 1/2 percentage point--in response to strong economic indicators and evidence of potential inflationary pressures. Market participants have revised up their trajectory for System tightening; futures quotes have built in an increase of 100 basis points in the federal funds rate by year-end, and further moves are expected early next year. However, major indexes of stock prices have changed little on net, as reports of stronger-than-expected corporate earnings have apparently offset the depressing effect of rising nominal interest rates.

The markets have essentially ignored the monetary aggregates. M2 edged down for the third straight month in October and is now at the bottom end of its 1994 growth range of 1 to 5 percent. The weakness in M2 has continued to reflect declines in household liquid deposits and savings accounts, as the rates paid on these accounts still have risen very little this year. In contrast, interest rates on small CDs and retail money funds have kept pace with market rates of late, tempering the substitution out of M2. M3 rose at an annual rate of 3-1/2 percent in October, boosted by a rebound in institution-only money funds and by continued issuance of large time deposits. Since the fourth quarter of 1993, M3 has increased at an annual rate of 1 percent, leaving the aggregate in the lower portion of its target range.

Bank credit expanded at an annual rate of 3 percent in October, an increase similar to those posted in August and September. As has been the pattern for some time, holdings of securities shrank last month; although some of the October decline resulted from marking to market, outright net sales provided funds to support further robust growth in bank lending. Consumer loans have continued to be particularly strong, rising at an annual rate of 18 percent in October. Business lending has also remained brisk in recent months, reflecting strong demand and a continued easing of terms. Real estate lending at banks grew moderately in October, after large gains in August and September.

Total net borrowing by nonfinancial businesses has picked up somewhat in recent months, even though public bond issuance has remained sluggish. The robust increase in bank borrowing has been accompanied by a jump in issuance of commercial paper since mid-September, most of which apparently has been merger-related. The volume of large merger deals completed this year is already more than double the total for 1993, and the elevated pace of activity shows no sign of abating. Net equity issuance turned negative in the third quarter, and likely has remained so, because of the slow pace of gross stock offerings and a fair amount of merger-related equity retirement.

Total consumer credit expanded vigorously again in September, consistent with the strength in household purchases of motor vehicles and other durable goods. Moreover, the bank data cited above suggest that overall lending to consumers posted another robust rise in October. Home mortgage lending appears to have continued increasing at least moderately. The effect of the monetary tightening to date has apparently been blunted by the growing initial discounts that banks and thrifts have offered on ARMs. In September, ARMs accounted for 46 percent of mortgage originations, the highest share in more than five years. Besides engaging in intense price competition, banks and thrifts have been easing downpayment requirements to attract borrowers.

In the municipal securities market, gross issuance of long-term tax-exempt debt has remained sluggish, with the volume of offerings in September and October more than 50 percent below levels of a year earlier. In addition, issuance of short-term debt has weakened from its brisk summer pace. The limited issuance, together with heavy retirements, implies that the outstanding stock of tax-exempt debt continued to decline through October. This reduced supply held down tax-exempt yields relative to Treasury rates through mid-October, but the yield ratio has jumped since then, in large part because of heavy net sales by mutual funds.

Treasury borrowing in the current quarter has picked up with the seasonal rise in the deficit. The mix of offerings this quarter will be distinctly skewed toward short maturities, with the Treasury relying on bills for nearly 60 percent of its net cash borrowing. In the agency market, both Fannie Mae and Freddie Mac have continued to borrow heavily to finance an aggressive expansion of their mortgage portfolios; the spread between rates on mortgage-backed securities and their own issues makes this a profitable strategy.

<u>Outlook</u>

The staff's economic and financial projections are based on the assumption that the System will further boost short-term interest rates in coming months in an effort to hold down inflation. Given the surprising momentum in economic activity, this projection builds in a more substantial tightening of policy than did the September projection. Because the market has already priced a significant tightening into the rate structure, we believe that longer-term rates will rise far less than short rates in the near term. Moreover, we expect that long rates will decline appreciably once economic activity moderates and inflation fears recede.

Both M2 and M3 are expected to accelerate slightly in 1995, despite the slower growth in nominal GDP.[1] In our projection, the opportunity costs of holding M2 and M3 assets rise less next year than they did in 1994, reducing the restraint on money growth from changes in interest rates. Even so, the velocities of M2 and M3 should grow considerably again next year. In 1996, we expect M2 velocity to decelerate further, boosting the growth of M2, as deposit rates continue to close the gap with market rates. Because the pickup in deposits should reduce the need for wholesale funding, we expect M3 growth in 1996 to hold at about the 1995 pace.

Total debt of the domestic nonfinancial sectors is projected to increase about 5 percent in both 1995 and 1996, little different from the moderate debt growth this year. Nonfederal borrowing is projected to rise at an annual rate of 5 percent this quarter and then to decelerate with the assumed moderation in economic activity. The growth of federal debt is expected to be unusually rapid in the first quarter of 1995, in part because the payments associated with an expansion of the earned income tax credit will boost the Treasury's cash needs. For 1995 as a whole, we project federal debt to grow about 6 percent, with the same increase expected for 1996.

In the household sector, growth in consumer credit will likely remain very strong through year-end, but then should moderate with the much slower growth of spending on durable goods and the rise in repayments on existing loans. Home mortgage debt is projected to increase about 5-1/2 percent in 1995 and 1996, similar to the rise this year but about 1 percentage point below the increases in 1992 and 1993. The outlook for growth in mortgage debt is consistent with our expectation that single-family housing activity--both new

1. In 1995, we project that nominal GDP will increase 4-1/4 percent, down 2 percentage points from the advance now expected for 1994.

construction and sales of existing homes -will remain below current levels throughout the forecast period. The debt-to-income ratio and debt service burden of the household sector are anticipated to rise somewhat over the forecast period. Delinquency rates could move higher, and although we do not expect a deterioration in credit quality that would prompt a major shift in lenders' attitudes, it would not be surprising to see rate spreads on consumer loans widen a bit and the promotion of credit cards abate.

The recent pickup in nonfinancial business borrowing is expected to persist into early next year, fueled by strong inventory investment and by merger activity. But the growth of nonfinancial business debt should slow thereafter. Net equity retirements are expected to diminish over the course of 1995, an important factor restraining the growth of business debt. In the near term, the unfavorable tone of the bond market suggests that firms will continue to rely heavily on bank loans, commercial paper, and other sources of short-term funding. However, by the second half of next year, we expect that business borrowing will tilt more toward bond issuance in response to a decline in long-term rates; this shift in the financing mix should continue in 1996. The swing toward more liberal terms and standards at banks and other lenders seems likely to end--and perhaps to reverse somewhat--as rising rates and softer business conditions raise concerns about credit quality.

In the state and local sector, slow growth of debt is expected to resume by mid-1995 after the unprecedented net run-off that has occurred this year and likely will continue for a few more quarters. Retirements will remain heavy over the forecast period, as debt that has been refunded in advance becomes callable. However, we expect new issuance to pick up with the anticipated downturn in long-term rates and the need to finance continuing fiscal deficits.

Confidential FR Class II
November 9, 1994

CHANGE IN DEBT OF THE DOMESTIC NONFINANCIAL SECTORS[1]
(Percent)

			Nonfederal						MEMO	
				Households						
	Total[2]	Federal govt.	Total	Total	Home mtg.	Cons. credit	Business	State and local govt.	Private financial assets	Nominal GDP
Year										
1982	9.8	19.7	7.4	5.5	4.7	4.4	8.8	9.3	10.1	3.2
1983	11.9	18.9	10.1	11.8	10.8	12.6	8.7	9.7	12.5	11.0
1984	14.6	16.9	13.9	13.0	11.7	18.7	15.6	9.1	12.8	9.1
1985	15.5	16.5	15.2	15.3	13.2	15.8	12.1	31.6	12.4	7.0
1986	12.3	13.6	11.9	12.0	14.3	9.6	12.2	9.8	7.3	4.7
1987	9.4	8.0	9.8	11.4	14.9	5.0	7.9	12.1	8.1	8.0
1988	8.9	8.0	9.2	10.5	12.7	7.2	8.7	6.0	8.6	7.7
1989	7.8	7.0	8.1	9.2	10.8	6.2	6.9	9.3	5.8	6.0
1990	6.3	11.0	5.0	6.5	7.9	2.0	3.4	5.7	4.7	4.7
1991	4.4	11.1	2.4	4.7	6.5	-1.8	-1.0	7.4	-1.0	3.5
1992	4.8	10.9	2.8	5.8	6.7	0.7	-0.1	1.8	0.7	6.4
1993	5.4	8.3	4.3	7.3	6.4	8.0	0.6	6.4	-0.7	5.0
1994	4.8	4.7	4.8	7.2	5.6	12.2	4.4	-3.8	4.4	6.2
1995	5.0	5.9	4.7	6.1	5.6	9.4	4.1	0.3	1.0	4.3
1996	4.9	5.8	4.6	6.0	5.6	7.9	3.5	1.9	1.0	4.7
Quarter (seasonally adjusted annual rates)										
1993:1	4.2	7.8	2.9	4.4	4.2	2.7	-0.3	8.7	-3.1	4.4
2	6.4	10.7	4.8	6.8	6.7	6.0	1.0	11.3	1.4	4.2
3	5.0	5.4	4.9	9.1	8.1	9.3	0.3	4.5	-2.3	3.8
4	5.5	8.4	4.5	8.3	6.2	13.2	1.2	0.6	1.4	7.7
1994:1	5.3	6.3	5.0	7.3	6.2	8.6	3.9	-1.1	9.2	6.1
2	3.9	3.6	4.0	6.2	3.6	13.4	4.0	-5.5	4.5	7.2
3	4.6	3.9	4.9	7.6	6.3	13.9	4.4	-5.2	1.9	5.2
4	4.9	4.6	5.0	7.1	5.9	11.0	4.8	-3.7	1.7	6.1
1995:1	6.2	10.1	4.7	6.0	5.6	10.2	4.5	-0.8	1.5	5.7
2	4.3	3.8	4.5	5.8	5.5	9.4	4.1	-0.1	0.6	4.2
3	4.5	4.4	4.6	6.0	5.5	8.7	3.8	0.8	0.7	3.6
4	4.7	5.0	4.6	5.8	5.4	8.1	3.8	1.3	1.0	3.8

1. Data after 1994:2 are staff projections. Year-to-year changes in nominal GDP are measured from the fourth quarter of the preceding year to the fourth quarter of the year indicated; other changes are measured from end of preceding period to end of period indicated.
2. On a quarterly average basis, total debt growth was 5.2 percent in 1993, and it is projected to be 5.0 percent in 1994 and 1995, and 4.9 in 1996.

2.6.3 FOF

Confident)FR Class II
November /994

FLOW OF FUNDS PROJECT..S: HIGHLIGHTS[1]
(Billions of dollars)

		Calendar year				-----1994-----				-----1995-----		
	1993	1994	1995	1996	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
					-----Seasonally Adjusted Annual Rates-----							
Net funds raised by domestic nonfinancial sectors												
1 Total	651.4	571.3	633.7	659.1	657.2	501.7	538.9	587.3	758.6	561.9	594.2	620.1
2 Net equity issuance	20.9	-20.9	-15.8	-8.0	-2.8	10.4	-48.0	-43.0	-39.0	-8.0	-8.0	-8.0
3 Net debt issuance	630.5	592.1	649.4	667.1	660.0	491.3	586.9	630.3	797.6	569.9	602.2	628.1
Borrowing sectors												
Nonfinancial business												
4 Financing gap[2]	28.8	71.9	125.4	122.3	22.1	75.3	91 2	98.8	119.6	129.2	125.6	127.2
5 Net equity issuance	20.9	-20.9	-15.8	-8.0	-2.8	10.4	-48.0	-43.0	-39.0	-8.0	-8.0	-8.0
6 Credit market borrowing	21.1	162.5	160.2	143.6	145.1	152.5	168.1	184.5	174.4	162.4	150.5	153.6
Households												
7 Net borrowing, of which:	293.8	310.7	278.8	290.8	315.7	269.7	335.4	322.0	278.0	272.7	284.5	279.8
8 Home mortgages	179.7	166.9	176.5	186.8	182.8	109.7	192.1	183.0	174.7	176.1	177.4	177.8
9 Consumer credit	64.4	106.1	91.7	84.2	74.4	118.7	127.0	104.2	99.2	94.2	89.2	84.2
10 Debt/DPI (percent)[3]	88.5	89.8	90.4	91.1	90.5	90.4	90.8	90 6	90.6	91.0	91.3	91.3
State and local governments												
11 Net borrowing	59.5	-37.8	3.0	17.8	-11.3	-53.8	-50.8	-35.2	-7.2	-1 2	7.8	12.8
12 Current surplus[4]	-45.5	-29.9	-27.4	-24.8	-29.1	-36.3	-25.6	-28.5	-25.7	-26.2	-28.0	-29.6
U.S. government												
13 Net borrowing	256.1	156.6	207.4	215.0	210.5	122.9	134.1	159.0	352.4	136.0	159.4	181.9
14 Net borrowing; quarterly, nsa	256.1	156.6	207.4	215.0	51.2	7.7	37.1	60.7	85.7	11.2	44.1	66.4
15 Unified deficit; quarterly, nsa	226.3	187.0	197.4	219.2	58.6	-0.3	53.5	75.2	97.5	-34.6	50.1	84.3
Funds supplied by												
16 depository institutions	140.4	206.4	198.6	188.8	203.4	155.0	233.1	234.1	207.9	197.6	199.1	189.8
MEMO: (percent of GDP)												
17 Dom. nonfinancial debt[3]	189.7	188.0	187.6	188.7	190.4	188.9	188.7	188.2	188.5	188.6	189.1	189 5
18 Dom. nonfinancial borrowing	9.9	8.8	9.2	9.0	10.0	7.3	8.7	9.2	11.4	8.1	8.5	8 8
19 U.S. government[5]	4.0	2.3	2.9	2.9	3.2	1.8	2.0	2.3	5.1	1.9	2.2	2 5
20 Private	5.9	6.5	6.2	6.1	6.8	5.5	6.7	6.9	6.4	6.2	6.2	6.2

1. Data after 1994:2 are staff projections.
2. For corporations: Excess of capital expenditures over U.S. internal funds.
3. Annuals are average debt levels in the year (computed as the average of year-end debt positions) divided by nominal GDP
4. NIPA surplus, net of retirement funds.
5. Excludes government-insured mortgage pool securities

INTERNATIONAL DEVELOPMENTS

Recent Developments

Since the September FOMC meeting, the weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies has declined nearly 1 percent on balance. The dollar declined 1-1/4 percent against the mark and 3/4 percent against the yen. During the intermeeting period, the dollar initially fluctuated narrowly but then fell in mid-October, in part because the Kohl victory in the German election contributed to mark appreciation. The dollar remained weak in light of data indicating continuing strength in the U.S. economy, suggesting the risk of emerging inflation, and of additional difficulties in U.S./Japan trade talks. On November 2, the dollar reached a new post-war low in terms of the yen and a two-year low against the mark; the Desk intervened to purchase marks and yen on that day and again on the following day. Over the two days, the Desk purchased $1.3 billion against marks and the same amount against yen, split evenly between the System and the Treasury. Since November 2, the dollar has appreciated nearly 1-1/2 percent on balance, with much of the increase coming after the U.S. election.

Long-term interest rates in the major foreign industrial countries showed mixed changes while rates in the United States rose about 30 basis points. German and French long-term rates changed little, on balance, whereas rates in Japan rose about 20 basis points and those in the United Kingdom fell 30 basis points. Three-month rates abroad were also somewhat mixed, with Canadian and U.K. rates up about 20 basis points and French and Japanese rates little-changed. U.S. Treasury bill rates increased 60 basis points.

. The Bank of Japan accounted for $3-1/2 billion. The Desk intervened only on November 2 and 3.

Economic activity in the major foreign countries continued to be robust in the third quarter. In western Germany, initial data for industrial production show a moderate gain for the third quarter. Expected upward revision to the September figure should raise third-quarter growth to about 4 percent at an annual rate. German manufacturing orders rose further in the third quarter, but at a somewhat less rapid pace than in the previous quarter. In France, the strong pace of economic growth in the second quarter appears to have continued into the third. Industrial production expanded further in July and August, as did consumption of manufactured products. U.K. industrial production rose strongly in September, and third-quarter GDP rose nearly 3 percent. Surveys of business attitudes remain favorable. Canadian industrial production, shipments, and orders increased sharply in August. Employment continued to rise through the third quarter, then dipped slightly in October, and the unemployment rate fell again in October. Consumer and business surveys indicated very positive sentiment in the third quarter. Recovery in Japan is still not firmly established, but economic activity in the third quarter appears to have strengthened, following a second-quarter decline. Industrial production and new car registrations rose in the third quarter, and orders for new machinery rebounded strongly in July and August.

Consumer price inflation remains low in the major foreign industrial countries, with the most recent data showing 12-month inflation of underlying consumer prices at 2 percent or less in Japan, France, the United Kingdom, and Canada.

The U.S. nominal trade deficit in goods and services narrowed in August. Nevertheless, for July and August combined, the trade deficit was substantially larger than it was in the second quarter.

Exports of goods rebounded in August, with sales of automotive products to Canada particularly strong. Exports of machinery and consumer goods rose moderately, and agricultural exports recovered sharply. Imports of goods rose further in August, with automotive trade with Canada again a factor. The quantity of oil imports remained strong in July and August, somewhat above the second-quarter pace, largely as a result of higher consumption. Preliminary data for September suggest that oil imports declined slightly as an easing of consumption more than offset rebuilding of stocks.

Prices of U.S. non-oil imports and nonagricultural exports each rose 0.3 percent in September. For the third quarter as a whole, non-oil import prices rose 5.3 percent at an annual rate, reflecting the exceptionally rapid rise in prices for food, feed, and beverages (largely coffee) as well as the strong increase in prices of industrial materials. Nonagricultural export prices rose 4.4 percent, annual rate, in the third quarter, led by prices for industrial supplies. While agricultural export prices rose in September, they declined again on average in the third quarter, reflecting the bountiful harvest. The price of imported oil rose only slightly in August, after sizable increases each month since April, and then fell in September as OPEC production increased. For the third quarter, the price of imported oil should average about $16.30 per barrel, approximately $1.65 per barrel more than in the second quarter. Spot oil prices have firmed in recent weeks.

Outlook

The staff projects that real GDP in foreign industrial and developing countries will increase at an annual rate of about 4 percent rate over the forecast period, somewhat above the rate projected in the previous Greenbook and significantly stronger than the forecast for the United States in 1995 and 1996 The dollar is projected to rise slightly from recent levels and then remain about unchanged. As a result of these developments and the decline in the dollar that has already occurred since the start of this year, real exports of goods and services are forecast to grow somewhat faster than real imports through 1996. Consequently, real net exports are projected to narrow slightly over the forecast period.

The dollar. We project that the foreign exchange value of the dollar in terms of the other G-10 currencies will move up a bit from recent levels through mid-1995, in association with the assumed rise in U.S. interest rates, and then remain about unchanged. This projected path is somewhat lower than that assumed in the September Greenbook, reflecting the decline in the dollar over the intermeeting period. A possible risk to this projection is that the recent weakness of the dollar might persist; alternatively, market participants might react particularly strongly and favorably as inflation risks are seen to diminish, resulting in a stronger dollar than we have incorporated in the Greenbook forecast. Our projection is that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will show a moderate depreciation on average through the end of the forecast period, little changed from the September Greenbook.

Foreign G-7 countries. Real GDP growth in the foreign G-7 countries (weighted by U.S. exports) is projected to average 3-3/4 percent in the current quarter and then to remain at about 3-1/2 percent through 1995 and 1996. This forecast has been revised slightly upward from that in the September Greenbook because of positive changes for France, Canada, and Italy.

In Germany, real output growth in the near term is expected to be above 3 percent, annual rate, and then to average about 3 percent over the remainder of the forecast period. The income tax surcharge scheduled to take effect in January is likely to slow consumption growth next year. In France, continued strength in domestic demand is expected to sustain growth in the near term and to contribute to some further strengthening--to about 3-1/2 percent, annual rate--in 1995 and 1996. In the United Kingdom, the rate of real output growth is expected to trend down from about 3-1/4 percent in the near term to 2-3/4 percent in 1996 as prospective monetary tightening has an effect. In part in response to the projected slowing in the U.S. economy, output growth in Canada is forecast to slow from 5 percent in 1994 to 4-1/4 percent in 1995 and then to slow a bit more in 1996. The strength of the recovery of real GDP growth in Japan is still uncertain. We expect growth to increase over the forecast period from the current annual rate of about 2 percent to 3-1/4 percent in 1996.

Consumer price inflation in the foreign G-7 countries is projected to remain low but to rise over the forecast period as the continued stronger activity reduces the amount of slack in those economies. On average, inflation in these six countries (weighted by U.S. import shares) is projected to increase from about 1 percent this year to nearly 2 percent in 1995 and 1996. This forecast reflects upward revisions to projected inflation in western Germany, Canada, and Italy and a slight downward revision for Japan.

The staff forecast incorporates the assumption that foreign short-term interest rates on average will soon move up as most central banks abroad react to the stronger activity in their respective economies; short-term rates on average are expected to move up about 70 basis points over the forecast period. This assumed path for short-term interest rates is somewhat above that in the previous Greenbook.

As in the United States, foreign long-term rates, on average, are expected to decline somewhat from current levels by the end of the forecast period, in light of the general tightening of monetary conditions and the persistence of favorable inflation performance.

Other countries. The real GDP of developing countries that are major U.S. trading partners (weighted by bilateral nonagricultural export shares) is forecast to increase about 5-1/2 percent per year over 1994-96. The external sectors of Asian developing countries should benefit from the strengthening recovery in the foreign industrial countries and from the appreciation of the yen. In Latin America, a progressive dismantling of trade barriers, large-scale privatization efforts, and strong domestic and foreign investment spending should facilitate growth in 1994-96.

The aggregate growth outlook for developing countries is basically unchanged since the last Greenbook, despite modest upward revisions to the growth forecasts for Brazil and Argentina. The upward revision to Brazil's forecast reflects improved prospects for achieving substantive economic reform in the wake of Cardoso's victory in the October presidential election. The growth forecast for Argentina was revised upward to reflect faster-than-expected growth in investment spending that should allow for a continued rapid expansion of output in 1995-96.

U.S. real net exports. Real net exports of goods and services are expected to narrow slightly over the forecast period from the rate observed in the third quarter of this year.

Rapid growth of real merchandise exports will be sustained by the strong pace of foreign output growth and the lagged effects of the decline in the dollar since the beginning of the year. Growth of computer exports is expected to continue at nearly the rapid pace of the third quarter through the end of the forecast period. Other nonagricultural exports are projected to grow about 6-1/4 percent in 1995-96. The level of agricultural exports is projected to change little over the forecast period.

TRADE QUANTITIES*
(percent change from end of previous period, saar)

	1993	1994			Projection 1995	Projection 1996
		H1	Q3	Q4		
Merchandise exports						
Total	6.1	7.2	14.6	12.4	9.4	10.3
Agricultural	-5.3	-8.0	44.3	0.3	-1.0	1.6
Computers	23.1	14.8	36.4	31.1	28.6	26.3
Other nonag.	4.5	7.3	7.6	9.8	6.0	6.5
Merchandise imports						
Total	13.1	16.8	13.8	8.3	6.8	7.8
Oil	10.0	7.7	23.8	-27.2	5.3	1.9
Computers	38.3	27.7	22.7	26.3	25.1	21.6
Other non-oil	9.3	15.7	10.8	9.7	2.7	4.6

* NIPA basis, 1987 dollars.

Growth of non-oil imports other than computers is expected to remain near 10 percent this quarter, to slow significantly to about 3 percent in 1995, and to strengthen in 1996. This deceleration reflects the projected slower U.S. GDP growth next year, the lagged effects of higher import price inflation in the near term, and the unwinding of a number of transitory factors that boosted imports in the second and third quarters. We expect the quantity of oil imports to fall in the current quarter as stocks are drawn down to more normal levels. Increased winter consumption should be met by slightly higher domestic production and stock draws. In 1995, imports of oil are projected to remain on an upward trend as U.S. oil consumption continues to increase in line with economic activity.

Oil prices. The fourth quarter assumption for the oil import unit value has been revised upward by nearly 80 cents to $15.82, owing to several developments: the massing of Iraqi troops on the

Kuwaiti border and an oil workers' strike in Brazil early in the quarter and the rupture of the Houston pipeline more recently. By the second quarter of 1995, the oil import unit value should return to our long-run view of $16.00 per barrel, consistent with continued global economic expansion, seasonally higher oil demand, and an anticipated rollover in OPEC's production quota through early 1995. Beyond the first quarter of 1995, we project WTI and the oil import price to be flat at $18.50 and $16.00 per barrel, respectively. We assume that Iraqi oil exports will return to world markets in 1996, permitting further increases in world oil demand to be met readily by increased supply.

SELECTED PRICE INDICATORS
(percent change from end of previous period except as noted, ar)

	1993	1994			------Projection----- 1995	1996
		H1	Q3	Q4		
PPI (export. wts.)	0.9	2.9	5.6	3.9	3.4	2.2
Nonag. exports*	0.7	3.2	5.7	4.1	3.0	1.8
Non-oil imports*	1.3	2.1	5.8	7.2	3.1	1.5
Oil imports (Q4 level, $/bl.)	14.09	14.67	16.30	15.82	16.00	16.00

* Excluding computers.

Prices of non-oil imports and exports. The prices of non-oil imports excluding computers are expected to accelerate further during the current quarter from their rapid third-quarter rate of increase. The substantial increases in non-oil commodity prices on world markets and the lagged effect of the decline in the dollar since early this year will exert upward pressure on import price inflation in the near term that then will wane in mid-1995. Import prices are expected to decelerate to about a 1-1/2 percent rate of increase in 1996. In the near term, prices of U.S. nonagricultural exports reflect the sharp increases in materials prices. For 1995-96, increases in nonagricultural export prices are expected to fall in line with the slowing of U.S. producer price inflation.

Nominal trade and current account balances. The trade deficit on goods and services is projected to narrow somewhat through 1996 as the deficit on merchandise trade improves slightly and the surplus on net service receipts increases. The deficit on net investment income is projected to widen, reflecting the path of interest rates and rising net indebtedness. We expect that, as a result of these developments, the current account deficit will average about $175 billion in 1995 and 1996, or 2.5 percent of GDP.

November 9, 1994

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REAL GDP AND CONSUMER PRICES, SELECTED COUNTRIES, 1992-96
(Percent change from fourth quarter to fourth quarter)

Measure and country	1992	1993	Projection 1994	Projection 1995	Projection 1996
REAL GDP					
Canada	0.5	3.2	5.0	4.3	3.8
France	0.6	-0.5	3.3	3.4	3.6
Germany	1.0	0.0	3.3	3.0	3.2
W. Germany	0.3	-0.5	2.8	2.5	2.6
Italy	-0.6	0.4	3.5	3.1	3.1
Japan	-0.3	-0.1	1.6	2.8	3.3
United Kingdom	0.3	2.6	3.6	3.1	2.7
Average, weighted by 1987-89 GDP	0.1	0.6	2.9	3.1	3.3
Average, weighted by share of U.S. nonagricultural exports					
Total foreign	1.6	2.7	4.1	3.9	4.0
Foreign G-7	0.3	1.8	3.8	3.6	3.5
Developing countries	3.9	4.7	5.2	5.1	5.3
CONSUMER PRICES					
Canada	1.8	1.8	0.1	2.2	2.3
France	1.8	2.1	1.7	1.5	1.5
Western Germany	3.7	3.7	2.8	2.3	2.5
Italy	4.8	4.1	3.6	4.2	4.0
Japan	0.9	1.2	0.7	0.8	0.7
United Kingdom	3.1	1.6	2.7	3.8	3.9
Average, weighted by 1987-89 GDP	2.4	2.2	1.8	2.2	2.2
Average, weighted by share of U.S. non-oil imports	1.9	1.9	1.1	1.8	1.9

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U.S. INTERNATIONAL TRANSACTIONS IN GOODS, SERVICES, AND THE CURRENT ACCOUNT

(Billions of dollars, seasonally adjusted annual rates)

	1992				1993				1994		ANNUAL		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	1991	1992	1993
NIPA Real Net Exports of Goods & Services (87$)	-17.9	-34.1	-38.9	-38.5	-57.6	-69.3	-86.3	-82.2	-104.0	-111.8	-19.5	-32.3	-73.9
Exports of G&S	571.0	573.1	580.5	590.7	589.2	600.2	595.3	625.2	619.6	643.9	542.6	578.8	602 5
Goods	416.0	421.5	427.4	441.1	433.9	443.3	438.5	468.1	464.4	484.6	397.1	426.5	445 9
Agricultural	38.9	38.4	40.5	41.3	39.1	39.3	36.9	39.1	36.6	37.5	35.5	39.8	38.6
Computers	47.1	52.3	56.2	60.1	60.9	62.9	68.5	74.0	76.9	79.3	41.4	53.9	66.6
Other Goods	330.0	330.8	330.7	339.8	333.9	341.1	333.1	355.1	350.9	367.8	320.2	332.8	340.8
Services	154.9	151.6	153.1	149.6	155.3	156.9	156.7	157.1	155.2	159.2	145.5	152.3	156 5
Imports of G&S	588.8	607.1	619.4	629.3	646.8	669.6	681.6	707.4	723.6	755.6	562.1	611.1	676.3
Goods	489.5	509.7	521.7	530.2	546.6	567.4	577.1	599.9	615.2	648.3	464.4	512.8	572 8
Oil	47.2	51.6	53.1	52.8	53.4	57.7	56.7	58.1	56.5	60.3	49.2	51.2	56 5
Computers	51.2	57.5	64.7	68.4	73.3	80.0	87.8	94.6	99.7	106.9	41.6	60.5	83.9
Other Goods	391.1	400.6	403.9	409.0	419.9	429 7	432.6	447.2	458.9	481.0	373.7	401.2	432.4
Services	99.3	97.4	97.7	99.0	100.1	102.2	104.5	107.6	108.5	107.4	97.7	98 3	103.6
Memo: (Percent change 1/)													
Exports of G&S	6.1	1.5	5.3	7.2	-1.0	7.7	-3.2	21.7	-3.5	16.6	8.1	5.0	5.8
Agricultural	13.4	-5.0	23.7	8.1	-19.7	2.1	-22.3	26.1	-23 2	10.2	10.9	9.5	-5.3
Computers	24.4	52.0	33.3	30.8	5.4	13.8	40.7	36.2	16.6	13.1	26.7	34.8	23.1
Other Goods	3.1	1.0	-0.1	11.5	-6.8	8.9	-9.1	29.2	-4.6	20.7	7.2	3.8	4.5
Services	5.9	-8.3	4.0	-8.8	16.1	4.2	-0.5	1.0	-4.8	10.7	4.7	-2.0	5.0
Imports of G&S	6.6	13.0	8.4	6.5	11.6	14.9	7.4	16.0	9.5	18.9	4.0	8.6	12.4
Oil	0.9	42.8	12.1	-2.2	4.6	36.3	-6.8	10.2	-10.6	29.7	8.3	12.1	10.0
Computers	53.5	59.1	60.3	24.9	31.9	41.9	45.1	34.8	23.4	32 2	45.6	48.7	38.3
Other Goods	2.4	10.1	3.3	5.1	11.1	9.7	2.7	14.2	10.9	20 7	2.9	5.2	9.3
Services	7.2	-7.4	1.2	5.4	4.5	8.7	9.3	12.4	3.4	-4.0	-6.2	1.4	8.7
Current Account Balance	-33.4	-66.2	-74.4	-97.5	-79.4	-102.4	-111.4	-122.3	-129.3	-147.9	-6.9	-67.9	-103.9
Goods & Serv (BOP), net	-15.5	-41.5	-51.1	-53.4	-57.7	-76.3	-89.0	-79.9	-97.3	-108.0	-28.5	-40 4	-75.7
Goods (BOP), net	-72.3	-97.3	-109.4	-105.3	-116.8	-134.9	-145.9	-132.7	-147.8	-167.1	-74.1	-96 1	-132.6
Services (BOP), net	56.8	55.8	58.3	52.0	59.1	58.6	56.9	52.8	50.5	59.0	45.6	55 7	56.8
Investment Income, net	9.7	6.5	4.9	-2.9	7.4	2.7	8.1	-2.4	-3.2	-10.0	14.8	4.5	4.0
Direct, net	50.8	51.0	47.1	42.0	54.6	50.8	55.9	48.4	45.9	43.0	55.4	47.7	52.4
Portfolio, net	-41.1	-44.5	-42.2	-44.9	-47.2	-48.1	-47.8	-50.8	-49.1	-53.0	-40.5	-43.2	-48.5
Unilateral Transfers, net	-27.7	-31.1	-28.2	-41.2	-29.1	-28.8	-30.5	-40.1	-28.7	-29.9	6.7	-32.0	-32.1

1/ Percent change (AR) from previous period; percent changes for annual data are calculated Q4/Q4.

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS IN GOODS, SERVICES, AND THE CURRENT ACCOUNT

(Billions of dollars, seasonally adjusted annual rates)

	1994		Projection 1995				1996				Projection ANNUAL		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1994	1995	1996
NIPA Real Net Exports of Goods & Services (87$)	-118.3	-114.4	-114.1	-112.4	-109.1	-105.7	-103.3	-100.2	-99.3	-99.4	-112.1	-110.3	-100.6
Exports of G&S	659.2	677.2	691.9	707.1	721.1	735.2	751.0	767.7	784.7	802.1	650.0	713.8	776.4
Goods	501.4	516.3	528.7	541.4	553.1	565.0	578.6	593.1	607.9	623.1	491.7	547.0	600.7
Agricultural	41.1	41.1	41.3	41.4	41.1	40.7	40.9	41.0	41.2	41.4	39.1	41.1	41 1
Computers	85.7	91.7	98.1	105.0	111.3	118.0	125.1	132.6	140.5	148.9	83.4	108.1	136.8
Other Goods	374.6	383.4	389.3	395.0	400.7	406.3	412 7	419.5	426.2	432.8	369.2	397.8	422.8
Services	157.8	160.9	163.3	165.7	168.0	170.2	172.3	174.6	176.8	179.0	158.3	166.8	175.7
Imports of G&S	777.5	791.6	806 0	819.4	830.2	840.9	854.2	868.0	884.0	901.6	762.1	824.2	876.9
Goods	669.6	683.0	696.6	709.2	719.4	729.5	742.1	755.0	770.1	786.6	654.0	713.7	763 4
Oil	63.6	58.7	58.6	60.7	61.5	61.9	62.9	62.6	62.7	63.0	59.8	60.7	62 8
Computers	112.5	119.3	127.0	134.6	142.0	149.1	156.6	164.4	172.6	181.3	109.6	138.2	168.7
Other Goods	493.5	505.0	511.0	513.9	515.9	518.5	522.5	528.0	534.8	542.3	484.6	514.8	531 9
Services	108.0	108.7	109.5	110.3	110.9	111.5	112.3	113.1	114.0	115.1	108.1	110.6	113.6
Memo: (Percent change 1/)													
Exports of G&S	9.8	11.4	9.0	9.0	8.2	8.1	8.8	9.2	9.1	9 2	8.3	8.6	9 1
Agricultural	44.3	0.3	1.5	0.7	-2.5	-3.6	1.5	1.5	1.6	1.6	5.2	-1.0	1.6
Computers	36.4	31.1	31.1	31.1	26.3	26.3	26.3	26.3	26.3	26.3	23.9	28.6	26.3
Other Goods	7.6	9.8	6.2	6.1	5.9	5.7	6.4	6.8	6.5	6.4	8.0	6.0	6.5
Services	-3.5	8.2	5.9	6.1	5.7	5.3	5.1	5.4	5.1	5.0	2.4	5.8	5.1
Imports of G&S	12.1	7.5	7.5	6.8	5.4	5.3	6.5	6.6	7.6	8.2	11.9	6.2	7.2
Oil	23.8	-27.2	-1.0	14.9	5.3	2.6	7.1	-2.1	0.5	2.4	1.1	5.3	1.9
Computers	22.7	26.3	28.7	26.3	23.9	21.5	21.6	21.6	21.6	21.6	26.1	25.1	21.6
Other Goods	10.8	9.7	4.8	2.3	1.6	2.0	3.1	4.2	5.2	5.7	12.9	2.7	4 6
Services	2.3	2.6	2.9	3.1	2.3	2.2	2.7	2.8	3.4	3.7	1.0	2.6	3 2
Current Account Balance	-165.7	-183.3	-178.0	-182.8	-175.7	-185.9	-172.5	-170.3	-163.0	-175.5	-156.5	-180.6	-170.4
Goods & Serv (BOP), net	-125.1	-127.5	-128.6	-124.3	-118.2	-113.0	-108.3	-103.0	-99.9	-97.8	-114.5	-121.0	-102.2
Goods (BOP), net	-180.5	-186.3	-189.9	-188.5	-185.5	-183.0	-180.8	-178.1	-177.4	-177.7	-170.4	-186.7	-178.5
Services (BOP), net	55.3	58.8	61.3	64.2	67.3	70.0	72.6	75.1	77 5	79.8	55.9	65.7	76 3
Investment Income, net	-9.5	-15.3	-17.5	-26.5	-25.5	-31.9	-31.8	-34.9	-30.6	-36.2	-9.5	-25.3	-33 4
Direct, net	44.5	47.7	48.5	48.1	49.2	50.8	51.9	53.8	55.8	57.6	45.3	49.2	54.8
Portfolio, net	-54.0	-63.0	-66 0	-74.6	-74.7	-82.7	-83.7	-88.6	-86.5	-93.8	-54.8	-74.5	-88.1
Unilateral Transfers, net	-31.0	-40.5	-32.0	-32.0	-32.0	-41.0	-32.5	-32.5	-32.5	-41.5	-32.5	-34.2	-34.8

1/ Percent change (AR) from previous period; percent changes for annual data are calculated Q4/Q4.