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Strictly Confidential (FR) Class II FOMC

January 25, 1995

SUMMARY AND OUTLOOK

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

Overview

Indicators of production and employment remained decidedly upbeat as 1994 ended, but some question marks did begin to appear on the demand side of the equation. Most notably, current estimates of retail sales for the fourth quarter show a flattening on a month-to-month basis. Although the staff still anticipates that the Commerce Department will publish a figure in the neighborhood of 5 percent for fourth-quarter real GDP growth this Friday, it seems likely that inventory investment will account for a somewhat larger share of the advance than we forecast in the last Greenbook.

Looking ahead, we continue to expect that there will be a substantial moderation of economic expansion over the next few quarters. The increases in interest rates to date should impose some further restraint on activity in a number of sectors. The net effect of Mexico's financial troubles and the Kobe earthquake will be to weaken U.S. net exports in the near term. And while there appear to be only isolated inventory overhangs, it seems unlikely that businesses will want to continue to add to their stocks as fast as they have in recent quarters.

That said, there is a considerable change in our forecast this time. Real GDP growth is forecast at about 2-1/4 percent in 1995 and 2-1/2 percent in 1996--an average of approximately 1/2 percentage point per year more than in the last Greenbook. This upward revision is not a reflection of a change in our assessment of the underlying tendencies in the economy. Rather, it is mainly attributable to an alteration of our assumption regarding monetary policy. The federal funds rate now is assumed to be held at 5-1/2 percent through 1996, rather than rising substantially by this spring. Our decision to change the policy assumption was driven primarily by the desire to provide a more useful baseline for policy discussion, given staff uncertainty about how aggressive the Committee might wish to be in restoring conditions conducive to a further slowing of inflation. A secondary consideration was that greater fiscal restraint now appears in prospect than had been built into our earlier forecasts.

On the price side, incoming statistics have again been more favorable than we had expected. But levels of resource utilization are higher now than we had anticipated, and the tenor of anecdotal evidence seems quite consistent with our assessment that the economy has passed beyond the point where favorable inflation trends are likely to be extended. In this forecast, the unemployment rate moves no higher than 5-1/2 percent, and we are projecting that the tightness of markets will be reflected in a gradual updrift in the rate of price increase, with a bit of a surge early this year as materials price increases show through to a degree.

Key Assumptions

An unchanged federal funds rate clearly is at odds with the expectations underlying the current term structure, which appear to be for an appreciable rise in the funds rate this year--to something around 7 percent. Bonds have rallied on occasion in recent weeks when analysts thought that Fed tightening might be delayed or lessened; however, weaker-than-expected economic news was often the reason for that conclusion. Thus, there is a risk that until there are more persuasive indications of a substantial moderation in activity and inflationary risks, the "failure" of the System to tighten might even, on net, have negative effects on bond prices, if the credibility of the anti-inflation commitment were once again called into question. Balancing the various considerations, our forecast embodies an anticipation that long rates may change little in the near term.

Subsequently, however, as indications of slackening growth and lessening commodity price pressures begin to mount, and as the fiscal authorities adopt new deficit-reduction measures, the conditions should be in place for a considerable bond rally; we have projected that bond yields will fall appreciably by the latter part of this year. Then, as the economy begins to accelerate again in 1996 and the underlying trend of inflation is perceived to be headed upward, rising inflation premia and expectations of Fed tightening are projected to cause bond yields to firm again.

The easier monetary conditions in this forecast are reflected in a somewhat lower path of the exchange value of the dollar. A moderate depreciation tends to boost net exports and, by the end of this year, about offsets the negative consequences of reduced foreign economic growth. Foreign growth is expected to average 3-1/2 percent over 1995-96, about 1/2 percentage point less than in the last Greenbook. Crude oil prices have firmed a bit sooner than projected in the last Greenbook. The spot price of West Texas intermediate now is projected to average just under $18 per barrel in the current quarter before leveling off at $18.50 in the third quarter--the same as in the December Greenbook.

Obviously, considerable uncertainty still attaches to the fiscal outlook. Constitutional amendments, changes in budget rules, and major alterations in programmatic priorities are all under discussion--and contentious debate. Laying no claim to special political acumen but needing to adopt some assumption, the staff has made the guess that a balanced budget amendment will be passed. We have further assumed that, in a modest installment toward actually achieving budget balance, the Congress will enact legislation that, on net, reduces the unified deficit for fiscal year 1996 $20 billion relative to baseline. Reflecting this policy change as well as the effects of stronger economic activity in the current forecast, the unified deficit for fiscal 1996 now is projected to total $169 billion--$35 billion less than in the December Greenbook and about $15 billion lower than our current estimate of the fiscal 1995 deficit.

Review of the Fourth Quarter of 1994

As indicated above, our forecast of real GDP growth in the fourth quarter of 1994--5 percent at an annual rate--is the same as in the December Greenbook. However, there have been a number of noteworthy compositional changes in this projection. Based on the sluggish non-auto retail sales figures for November and December, real PCE now is estimated to have risen at a 4-1/2 percent annual rate--1 percentage point less than in the earlier forecast. Though this still is a sizable gain in outlays, it falls well short of the rapid 7 percent growth projected for real disposable personal income and thus implies a considerable increase in the personal saving rate. Given the upbeat sentiment reported in recent household surveys, this pattern seems surprising and might suggest the potential for a future upward revision to the retail sales data--or a catchup in the current quarter, which would be consistent with the anecdotal reports of strong January sales.

Single-family housing starts rose further in November and December, and we have revised upward our forecast of real residential investment in the fourth quarter. Although favorable weather conditions may have given a small boost to construction, the underlying momentum in housing activity evidently has been stronger than we previously thought. Builders and realtors report a recent softening in demand in response to the hikes in ARM rates that followed the last System tightening step, but the normal seasonal drop-off is so great in the winter that some caution is warranted in interpreting these readings.

In the business sector, real fixed investment probably rose at more than a 20 percent annual rate, which would exceed our earlier expectations. The data on orders and shipments through November suggest a whopping gain in expenditures for equipment, especially of the high-tech variety, and nonresidential construction activity has accelerated in all major market segments. Firms also have been willing to add to their inventories. We had expected some moderation in the pace of stockbuilding in the fourth quarter, but it now appears probable that inventory accumulation picked up at least a little further. Over the past three quarters, businesses have added to their stocks at about a 6 percent annual rate, and inventory-sales ratios have increased. At this point, most of the buildup appears to have been intended, with only scattered reports of inventory imbalances--mainly in retailers' stocks of seasonal merchandise and at auto dealers.

Labor markets have tightened still further, with the unemployment rate falling to 5.4 percent in December. And with last month's surge in production, factory capacity utilization jumped to 85 percent. To date, however, these high levels of resource utilization have not translated into a pickup in consumer price inflation.

Although the recent data on average hourly earnings hint at a modest acceleration of wages, we expect that the fourth-quarter Employment Cost Indexes will show continued moderation in benefits costs. Subdued unit labor costs evidently have offset the effects of rapid increases in materials costs and put a damper on increases in consumer prices. The "core" rate of inflation--as measured by the CPI excluding food and energy--actually moved down further in the fourth quarter. Given the noise in the data, we would not attach any special significance to this recent slowing per se, but it does reinforce the sense that inflation remained in check through the end of 1994. Anecdotal reports on the price situation are a mixed bag. Some firms say they will be attempting to pass along higher materials prices in early 1995 while others indicate that raising prices would put them at risk of losing market share.

The Outlook for 1995 and 1996

Economic activity is expected to continue increasing fairly rapidly in early 1995 but to decelerate substantially thereafter. This pattern of growth, in part, reflects the lagged effects of the earlier interest rate hikes on housing and other components of domestic final demand. And while, in the wake of the fourth-quarter uptick, some diminution in the pace of inventory accumulation seems likely in the near term, we expect businesses to seek to cut back their stockbuilding more sharply once they perceive some moderation in sales; the trimming in their orders will feed back on employment and income, further damping final demand.

The timing of these inventory adjustments is impossible to predict with any confidence, and this clearly represents a major source of uncertainty in the forecast. Recent international developments also have added to the uncertainty in the outlook. We are assuming that a financial assistance package will be approved for Mexico, but conditions could remain volatile for a while, with potential effects on the fortunes of other developing countries; meanwhile, it is still much too early to arrive at a solid assessment of the effects of the Kobe earthquake on Japanese production and trade activity. Our working assumption is that these influences will be a net negative for U.S. net exports, but only in the near term.

SUMMARY OF STAFF REAL GDP PROJECTION FOR 1995-1996
(Percent change, at annual rates)

	1994	1995 H1	1995 H2	1996
Real GDP	4.1	2.6	1.7	2.5
Previous	4.1	2.5	1.3	1.8
Real PCE	3.4	3.4	2.2	2.4
Previous	3.7	2.9	1.4	1.8
Real BFI	13.9	12.4	7.2	6.6
Previous	13.2	12.0	6.3	3.6
Real residential inv.	2.4	1.7	-2.7	-.1
Previous	1.6	-4.5	-1.2	1.4

On balance, we are projecting that real GDP will increase at a 3-1/4 percent annual rate in the current quarter, before slowing to an annual pace of less than 2 percent over the remainder of the year. The drop-off in growth in the latter half of the year is milder than in the December Greenbook, owing in part to the change in monetary policy assumptions.

In 1996, real GDP is projected to increase 2-1/2 percent, 3/4 percentage point faster than in the December Greenbook. As in the last forecast, economic activity accelerates next year as the inventory adjustment is completed. Although the amount of fiscal restraint in 1996 is greater than in the last projection, this is more than offset by lower interest rates and the accompanying higher values of shares and other assets--and by the effects of a weaker dollar on U.S. net exports.

Consumer spending. All indications are that employment growth is still proceeding apace and that increases in labor income will continue to be sizable in the near term. Given the optimism currently prevailing among consumers, we expect real PCE to increase more rapidly than income in the first half--reversing all of the unexplained uptick in the personal saving rate late last year. There have been some reports of a softening in motor vehicle demand this month, but the news from other retailers generally has pointed to a strong pace of sales. In addition, unless there is a continuation of abnormally warm weather, there will be a small boost to spending this quarter from a rebound in heating expenditures.

After increasing at a 4 percent annual rate in the current quarter, real consumer spending is forecast to post a healthy 2-3/4 percent (annual rate) gain in the second quarter. Thereafter, consumption growth is expected to moderate to an average annual pace of 2-1/4 percent over the remainder of the forecast period, reflecting the projected slower gains in real incomes, the satisfaction of pent-up demands, and the lagged effects of higher interest rates on the demand for durable goods. On the latter score, we would expect that rates on auto loans and other consumer credit would adjust more fully to the rise that has already occurred in market rates.

Under the assumed interest rates, we do not anticipate that changes in net worth would be a major factor affecting the propensity of households to spend their income. Nor, focusing just on the liability side of the balance sheet, do we see household debt burdens as prompting any retrenchment. To be sure, aggregate indebtedness has risen appreciably in the past couple of years, but the ratio of debt service to income has been held down by relatively low interest rates. There are no signs that consumers are encountering difficulty in meeting their repayment obligations, and any deterioration going forward is likely to be mild in the projected economic environment. Lenders are likely to remain quite willing to supply credit to those who want it.

Residential investment. Housing activity was surprisingly buoyant last year in the face of rising interest rates. The easing of downpayment requirements and the availability of a wider array of aggressively priced mortgage instruments may well have played a role in dulling the effects of the rate rise, and the phenomenon of huseholds' buying in advance of further rate increases might have been more important than usual in sustaining demand; however, it is our judgment that the most important factor has been the strength of employment and income growth, which has given more households the wherewithal and confidence to make home purchases.

Given this interpretation, while we think it likely that there is some lagged effect of last year's mortgage rate increase still to be felt, the favorable near-term outlook for job creation and income generation has led us to project that single-family housing starts will average 1.19 million units (annual rate) in the current quarter--somewhat less than in December but equal to the pace of the fourth quarter as a whole. Then, despite some easing in nominal FRM rates, we are looking for single-family starts to move lower as economic activity decelerates this year, reaching an annual rate of 1.12 million units by the fourth quarter. In 1996, although mortgage rates are projected to increase, a step-up in income growth is expected to result in a slight increase in single-family starts--to a 1.14 million unit pace by the end of next year.

In the multifamily market, starts also moved up in the fourth quarter, and we expect the gradual uptrend in this sector to continue over the next two years. Vacancy rates have eased a good bit in some parts of the country, and financing appears to be available to builders. As a result, multifamily housing starts are projected to total 310,000 units in 1995 and 340,000 units in 1996.

The projected overall level of housing construction, exceeding 1.4 million units in both 1995 and 1996, appears to be somewhat higher than might be dictated by longer-range demographic trends. The pace of starts is fairly high relative to the trend rate of household formation. This observation, along with the possibility that the lagged effects of the rise in mortgage rates last year will prove substantial, would suggest some downside risk to the forecast. On the other hand, there is arguably a sizable pent-up demand for home ownership, particularly among younger age groups, which could provide a greater lift to single-family construction than we have anticipated--especially given the favorable cash-flow affordability of homes. In the short run, satisfaction of that demand might well be only partially offset in weaker multifamily building and thus overall starts could rise. All things considered, the forecast risks seem reasonably balanced, given the projected economic and interest rate environment.

Business fixed investment. As noted above, business fixed investment surged at the end of 1994, and at this point, leading indicators such as permits and orders look to be quite robust. Nevertheless, we expect that equipment spending, especially, will decelerate substantially in the near term. One reason is that the estimated sharp increase in motor vehicle purchases in the fourth quarter is unlikely to be repeated, given the apparently ample level of sales to daily-rental fleets late last year and the constraints on heavy truck production. In addition, maintenance of the fourth-quarter growth pace of outlays for computers and some other types of equipment also would seem improbable, partly because of supply constraints that have been reflected to some degree in rising order backlogs.[1] All that said, real PDE is projected to increase about 12 percent, at an annual rate, in the current quarter--about half the rate of the fourth quarter but in line with the brisk average pace of the first three quarters of 1994.

As the effect of the acceleration in output growth last year wanes and as firms increasingly find themselves forced to rely on external financing of their expenditures, we expect that equipment outlays will decelerate appreciably further. Real PDE growth is projected at about 6 percent in the fourth quarter of this year and at the same pace during 1996. Our reading of the orders trends and trade reports on prices and product innovations suggests that real expenditures on office and computing machines (OCM) will continue to rise extremely rapidly in the near term. But we do not believe that these outlays are totally immune from the broader cyclical influences, and real OCM purchases are projected to decelerate to a 14 percent increase in 1996 after matching 1994's 20 percent gain this year. Purchases of other types of equipment are expected to slow more substantially: After advancing 15-1/4 percent in 1994, real spending on these assets is projected to rise less than 3 percent in 1996.

Investment in nonresidential structures is projected to be strong in the next two years. After increasing an estimated 5-3/4 percent in 1994, real NRS is forecast to grow at almost a 9 percent average annual rate in 1995 and 1996. The largest gains are expected to be for industrial construction, reflecting pressures on capacity, and for commercial structures such as retail stores and warehouses. Office building also is projected to grow briskly, albeit from a very low level; all indications are that the market

1. In fact, some firms might well not wish to take delivery of equipment any faster than is scheduled, given the need to have proper staffing and physical facilities.

for office space has firmed considerably in many locales and that lenders and investors are much more willing to commit capital to this sector. Although we have raised our forecast of NRS growth in this Greenbook, the risks in this sector may still be skewed to the upside.

Inventory investment. It is our view that businesses still are working hard to minimize inventories and that the rise in inventory-sales ratios last year was for the most part a measured response to the increased risk of running out of materials or merchandise under tighter supply conditions. The anticipation of price hikes was probably of lesser importance but was nonetheless a factor in some instances. In the projection, firms begin to perceive a slackening in the expansion of final demand--and as the projected decline in manufacturing capacity utilization leads to an improvement in vendor performance--target inventory-sales ratios are likely to fall promptly.

Because of the contractionary effects of their efforts on employment and demand, businesses may not accomplish the gearing down in inventory investment as quickly as they would like. Nonetheless, we expect that the rate of growth of stocks will be at or below that of final sales by the end of this year. The aggregate inventory-sales ratio is projected to decline a bit in 1996. On net, the slowing in inventory investment is projected to subtract more than 1/2 percentage point from real GDP growth this year and to be a slight drag in 1996. In 1994, the pickup in inventory accumulation accounted for about a point of GDP growth, so in this simple accounting, the swing in inventory investment explains most of the forecasted deceleration in economic activity from last year's pace.

Government. The assumed fiscal policy changes affect the staff forecast through a number of channels on both the income and expenditure sides of the national accounts. Our assumed package includes a $12 billion reduction in taxes in the form of a child tax credit and an increase of $2 billion in defense spending, which are more than offset by reductions in federal nondefense purchases of goods and services ($7 billion), transfer payments ($23 billion), and grants to states and localities ($4 billion). Although there is currently some discussion of altering PAYGO rules, our assumptions are consistent with current rules. Obviously, these particulars are every bit as conjectural as the overall dimension of the package--but compositional details probably are of secondary importance in terms of short-term aggregate demand consequences. With the assumed deficit-reduction effort, fiscal policy would be moderately restrictive.

On balance, we are projecting that real federal purchases will fall about 5 percent this year, with a 5-1/2 percent decline in real defense spending and a 3-3/4 percent drop in real nondefense purchases. In 1996, real federal purchases are projected to fall 4 percent, led by a 4-1/2 percent decline in defense spending and a 3-1/2 percent decrease in nondefense purchases.

The financial health of most state and local governments has improved over the past year as a consequence of the extra revenues generated by stronger-than-expected economic activity. However, not all units are flush, and in many instances where revenues are ample, political pressure for tax cuts is intense. Moreover, on our fiscal policy assumptions, federal assistance will be reduced somewhat. As a result, we expect that state and local purchases will continue to rise at a rather slow pace by historical standards: 2-1/4 percent in both 1995 and 1996.

Net exports. The outlook for the U.S. external sector is considerably weaker in the first half of 1995 than in the December Greenbook, reflecting mainly the net effects of economic developments in Mexico and, to a lesser extent, earthquake-related disruptions of Japanese trade activity. Looking beyond the near term, the outlook for real net exports differs little from the last forecast, as the stimulative effects of the lower projected path for the exchange rate are essentially offset by faster growth in the United States and some reduction in projected increases in economic activity abroad. (A fuller discussion of these developments is contained in the International Developments section.)

Labor markets. Labor demand is projected to remain robust in the near term, as firms continue to adjust their staffing levels in light of the recent strong pace of activity and a generally positive outlook for the economy. In some cases, pressures to rely less heavily on overtime will encourage extra hiring. Private surveys point to a rapid pace of hiring, and the recent low level of initial claims for unemployment insurance is consistent with strong employment growth. We expect payroll gains to average 270,000 per month in the first quarter, a pace comparable to that in 1994.

STAFF LABOR MARKET PROJECTIONS
(Percent change, Q4 to Q4, unless otherwise noted)

	1994	1995	1996
Output per hour, nonfarm business	1.1	.7	1.5
Previous	1.2	.8	1.2
Nonfarm payroll employment	3.0	2.2	1.2
Previous	3.0	1.8	.8
Civilian unemployment rate[1]	5.6	5.4	5.5
Previous	5.6	5.7	6.1

1. Average for the fourth quarter.

Looking beyond the current quarter, we expect hiring to slow--but not as much as the deceleration in output--leading to a deterioration in labor productivity growth. A lagging adjustment of labor hours to changes in output is the norm, a pattern reflecting both recognition delays and the "hoarding" of experienced workers until it is determined that the softening in demand is more than transitory. The recent heavier use of temporary help and overtime could reduce the hoarding tendency, but the higher perceived fixed costs of hiring and firing work in the other direction. Be that as it may, the projected slackening in activity is not great by cyclical standards, and thus labor productivity still increases 3/4 percent this year. Growth in output per hour moves back to trend in 1996, at 1-1/2 percent; this offsets the effect of the pickup in GDP growth on employment, which continues to expand rather slowly.

Labor force participation typically increases when job availability improves, but that pattern failed to emerge decisively in 1994. We are assuming that there will be a moderate increase in the participation rate over the next two years but with more of the rise occurring in the next few quarters, before employment growth slackens.

Despite the near-term rise in participation, the unemployment rate is forecast to slip to 5.3 percent in the first half of this year. With real GDP growth dropping below its potential pace of close to 2-1/2 percent, the unemployment rate returns to 5-1/2 percent by the first quarter of 1996 and remains at that level during the rest of next year.

Wages and prices. Both unemployment and industrial capacity utilization have moved past the rates that would lead us to expect an acceleration of wages and prices. Nonetheless, indications of a broad pickup in inflation obviously have yet to materialize. These developments raise some question about whether the Phillips curve is "working" and particularly whether the NAIRU might be lower than 6 percent. We have reexamined the set of econometric models that we use to assist us in our inflation forecasts, and the experience of 1994 is generally well within their confidence intervals. Moreover, the increasing number of reports in the Beige Book and elsewhere of wage and price pressures seems consistent with what is to be expected if the economy has passed the point of full employment. Although the picture is not uniform across all indicators, most alternative measures of labor market tightness have moved into the ranges observed in the late 1980s, when inflation picked up. Consequently, we have decided that we should make no significant change in our working assumption regarding the NAIRU, which we take to be about 6 percent.

STAFF INFLATION PROJECTIONS
(Percent change, Q4 to Q4, unless otherwise noted)

	1994	1995	1996
Consumer price index	2.7	2.9	3.1
Previous	2.7	3.0	2.9
Excluding food and energy	2.8	3.2	3.3
Previous	2.9	3.2	3.1
ECI for compensation of private industry workers[1]	3.3	3.7	4.0
Previous	3.3	3.7	3.7

1. December to December.

Applying customary rules of thumb, the roughly 1/2 percentage point differential between the projected level of the actual unemployment rate and the NAIRU would imply an acceleration of 3/4 to 1 percent in hourly compensation over the next two years. Our forecast is on the low side of that range, with the ECI index for private compensation accelerating from a predicted 3.3 percent increase in 1994, to 3.7 percent in 1995 and 4 percent in 1996.[2] The slightly "optimistic" tilt in the forecast reflects two considerations. First, it would appear that there is still enough insecurity among workers that they may be less aggressive than in the past in pushing for higher wages; in many collective bargaining situations, it is likely that unions will continue to trade away some amount of wage increase for promises to limit outsourcing or to guarantee employment levels.[3] Second, we think that benefit increases may be considerably restrained by success in reducing health insurance costs; many firms probably have yet to avail themselves of the savings from shifting to managed care systems. In addition, heightened competition among health-care organizations reportedly has curbed premium rates for this year. Although these benefit savings should largely be passed on over time to workers in the form of higher wages and salaries, the trade-off is probably less than complete in the short run. Indeed, we suspect that the structural change in the health sector has helped retard inflation in the past year or so, partly through this labor cost channel.

Core inflation--as measured by the CPI excluding food and energy--is forecast to rise at a 3.3 percent annual rate in the first quarter, boosted by the increase in postal rates and by a pass-through of higher materials costs. On the latter point,

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2. The acceleration in hourly compensation is projected to be greater than that in prices. The resultant pick-up in the growth of real wages in this forecast is consistent with a tightening of labor markets. When measured in product price terms (using the GDP deflator, which is expected to rise 2-1/2 percent per year), real compensation gains would only approximate the longer-term productivity trend--again, an indication that we are anticipating a rather moderate response to cyclical pressures.

3. The staff forecast does not incorporate a change in the level of the minimum wage. Although President Clinton proposed an increase in the State of the Union address, the Administration has not yet made a formal proposal and congressional approval is by no means assured. We estimate that a 75 cent increase in the minimum wage to $5 per hour would add roughly 1/4 percentage point to the growth in hourly compensation in the year it occurred.

manufacturing productivity increases evidently remained strong through the end of last year, so that the behavior of finished goods prices may reflect unusually subdued unit labor costs--which might suggest less latent inflation risk. On the other hand, the failure of finished goods prices to mirror the sharp rise in the prices of raw materials and intermediate components over the past half year is somewhat at odds with prior average patterns. The timing of cost "pass-throughs" in past cycles was sufficiently variable that the lags simply could turn out to be longer in the present case. However, given anecdotal reports of large, turn-of-the-year price increases on a variety of goods and services, and the prospect of tight markets producing further sizable increases in materials costs, we believe there is some danger that we may be underestimating the first-half price increase.

Looking beyond the current quarter, core inflation is forecast to drop back to a 3.1 percent annual rate in the second quarter and to rise gradually from there. After a 2.8 percent increase in 1994, the CPI excluding food and energy is forecast to rise 3.2 percent in 1995 and 3.3 percent in 1996. The acceleration reflects the pass-through of the higher hourly compensation as well as somewhat larger increases in non-oil import prices in this forecast. The overall CPI is forecast to rise 2.9 percent in 1995 and 3.1 percent in 1996, held down relative to the core rate by continued moderate increases in food and energy prices.

The pattern of wage and price developments, along with other factors, is expected to lead to a decline in the profit share of GDP. Such a decline is in line with what might be expected when output and productivity decelerate considerably. Note, however, that the profit share rose substantially over the past few years, and the 8.2 percent level of the third quarter (the last available observation) is the highest since 1979. The 7-1/2 percent level projected for 1996 would still be high by the standards of recent years.

Alternative Simulation

Under the baseline assumption of no change in the nominal federal funds rate over the projection period, we have forecast that the unemployment rate would remain below the staff's estimate of the NAIRU and inflation would drift upward. In light of the stated objective of the Committee of achieving price stability and to provide background information for the choice of policy options, an alternative simulation was run with the Board staff's macroeconomic model. The alternative simulation is based on an assumption that the federal funds rate is raised to about 7 percent by midsummer and is held close to that level in 1996. This probably is not far from the expectations prevailing in the markets at this time.

The results of this simulation are presented in the table below. Under the tighter policy assumption, a significant slowdown in economic growth occurs over the next two years, with the unemployment rate rising to 6 percent by the end of 1996. With the slack effects of a higher unemployment rate being reinforced by favorable exchange rate effects, inflation would be held in check.

ALTERNATIVE SIMULATION
(Percent change, Q4 to Q4, unless otherwise noted)

	1994	1995	1996
Real GDP	4.1	1.9	1.4
Baseline	4.1	2.2	2.5
Civilian unemployment rate[1]	5.6	5.5	6.0
Baseline	5.6	5.4	5.5
CPI excluding food and energy	2.8	3.0	2.9
Baseline	2.8	3.2	3.3

1. Average for the fourth quarter.

Strictly Confidential (FR)
Class II FOMC

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

January 25, 1995

Interval	Nominal GDP 12/14/94	Nominal GDP 1/25/95	Real GDP 12/14/94	Real GDP 1/25/95	GDP fixed-weight price index 12/14/94	GDP fixed-weight price index 1/25/95	Consumer price index[1] 12/14/94	Consumer price index[1] 1/25/95	Unemployment rate (level except as noted) 12/14/94	Unemployment rate (level except as noted) 1/25/95
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	6.2	6.3	4.1	4.1	2.7	2.7	2.7	2.6	6.1	6.1
1995	5.6	5.7	3.1	3.2	3.1	3.0	3.0	3.0	5.6	5.4
1996	4.2	4.6	1.6	2.2	2.9	2.9	2.9	3.0	6.0	5.5
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]	7.2	7.2	4.1	4.1	2.9	2.9	2.8	2.8	6.2	6.2
Q3[2]	5.9	6.2	3.9	4.0	2.8	3.0	3.6	3.6	6.0	6.0
Q4	6.9	6.8	5.0	5.0	2.7	2.5	2.3	2.4	5.6	5.6
1995 Q1	6.3	6.4	3.0	3.2	3.6	3.5	3.1	2.9	5.5	5.3
Q2	4.7	4.5	2.0	2.0	3.0	2.9	3.2	2.9	5.5	5.3
Q3	3.9	4.1	1.3	1.7	2.9	2.8	3.0	3.0	5.6	5.4
Q4	3.6	4.0	1.2	1.7	2.7	2.8	2.8	3.0	5.7	5.4
1996 Q1	4.1	4.7	1.4	2.0	3.2	3.1	2.9	3.0	5.9	5.5
Q2	4.3	5.0	1.8	2.5	2.9	2.9	2.9	3.1	6.0	5.5
Q3	4.6	5.2	2.0	2.6	2.9	3.0	2.9	3.1	6.1	5.5
Q4	4.7	5.2	2.1	2.6	2.9	3.0	2.9	3.2	6.1	5.5
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]	6.6	6.6	3.7	3.7	3.0	3.0	2.4	2.4	-.3	-.3
Q4	6.4	6.5	4.5	4.5	2.8	2.7	2.9	2.9	-.6	-.6
1995 Q2	5.5	5.4	2.5	2.6	3.3	3.2	3.2	2.9	-.1	-.3
Q4	3.7	4.1	1.3	1.7	2.8	2.8	2.9	3.0	.2	.1
1996 Q2	4.2	4.9	1.6	2.3	3.0	3.0	2.9	3.1	.3	.1
Q4	4.6	5.2	2.1	2.6	2.9	3.0	2.9	3.1	.1	0
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	6.5	6.6	4.1	4.1	2.9	2.8	2.7	2.7	-.9	-.9
1995 Q4	4.6	4.8	1.9	2.2	3.1	3.0	3.0	2.9	.1	-.2
1996 Q4	4.4	5.0	1.8	2.5	3.0	3.0	2.9	3.1	.4	.1

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)

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	6740.1	7123.6	7454 1
Real GDP	Bill 87$	4718 6	4838 0	4897 3	4867 6	4979.3	5134 5	5343 8	5514 5	5633 1
Real GDP	% change	3 3	1 6	2	3	3 7	3 1	4 1	2.2	2.5
Gross domestic purchases		2 5	.9	- 4	- 1	4 1	3 9	4 8	2.4	2.3
Final sales		4 2	1.5	1 2	- 4	3 8	3 0	3.2	2.9	2.7
Private dom final purch		4 2	5	-.1	-.8	5 1	5.0	4 8	3.7	3.0
Personal cons expend		4 2	1 2	7	.0	4 2	3 0	3.4	2.8	2.4
Durables		8.5	- 5	-.8	-1.3	9 6	9 0	8.4	3.3	2 7
Nondurables		3 2	1 2	- 1	-1 6	3.2	1.3	2 7	2.8	2 2
Services		3 7	1 7	1.7	1.2	3 5	2 5	2 4	2.6	2 4
Business fixed invest		5.5	- 4	7	-6 2	6 7	16.0	13 9	9 8	6 6
Producers' dur equip.		9 1	-1.7	2.9	-3 2	11 0	21.3	16.5	10 0	6 0
Nonres structures		-1 2	2.3	-3 9	-12 4	-3 4	1 6	5 7	9 0	8 8
Res. structures		9	-7 7	-15.2	7	17 0	8 1	2 4	- 6	- 1
Exports		13.5	11.3	6 7	8.1	5.0	5 8	10.4	7 5	9 2
Imports		3.6	2.6	.4	4 0	8 6	12 4	14.8	7 9	7 2
Government purchases		2	2.0	3 3	- 8	7	-1 0	-.7	-.3	1
Federal		-3.4	- 6	2.8	-3 2	8	-6.9	-5 3	-4 9	-4 1
Defense		-3.2	-1 5	1 5	-7.0	-1.3	-9.0	-7 2	-5.5	-4 5
State and local		2.9	4 0	3 6	8	6	3.0	2.0	2.3	2 3
Change in bus invent	Bill. 87$	19.9	29 8	5.7	-1.1	2.5	15 3	50 8	38.4	19.7
Nonfarm		26 9	29 9	3.2	-1.3	-2.0	18 5	43 7	35.3	17.3
Net exports		-104 0	-73 7	-54 7	-19.5	-32.3	-73 9	-113.6	-134 6	-129.4
Nominal GDP	% change	7 7	6.0	4 7	3.5	6 4	5 0	6 6	4 8	5 0
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employ.	Millions	105.2	107 9	109.4	108 3	108 6	110 5	113 4	116 5	118 1
Unemployment rate	%	5 5	5.3	5 5	6 7	7 4	6 8	6 1	5 4	5 5
Industrial prod index	% change	3 2	- 1	-.2	2	4 0	3.6	5 9	3.4	3 0
Capacity util rate-mfg.	%	83 6	83.2	81.3	78 0	79 2	80 9	83 4	84 8	84 0
Housing starts	Millions	1.49	1 38	1 19	1 01	1 20	1.29	1 45	1 47	1 47
Light Motor Vehicle Sales		15.43	14 53	13 85	12.31	12.80	13.89	15 07	15.10	15.10
Auto sales in U S		10 63	9 91	9 50	8.39	8.35	8 72	9 23	9 23	9.10
North American prod.		7 54	7 08	6.90	6.14	6.26	6 75	7 28	7 44	7 35
Other		3 10	2 83	2.60	2.25	2.10	1 97	1 96	1.79	1.75
INCOME AND SAVING										
Nominal GNP	Bill $	4908 2	5266 8	5567.8	5740 8	6025.8	6347 8	6730 5	7099 1	7421 2
Nominal GNP	% change	7 8	6 1	4 9	3.2	6.1	5 0	6 3	4 6	4 9
Nominal personal income		7 1	6 5	6 5	3.7	8.1	2 8	6 9	5.6	5.4
Real disposable income		3 2	1 1	1.1	9	5.0	5	4 2	2 2	2 5
Personal saving rate	%	4 4	4 0	4 2	5.0	5.5	4 1	4.1	4 3	4 3
Corp. profits, IVA&CCAdj	% change	10 2	-6 3	2.3	8.8	9 6	23 4	4.4	-3.0	6 5
Profit share of GNP	%	7.4	6 9	6.8	6.8	6 7	7 7	8.1	7 7	7 5
Federal surpl./def	Bill. $	-136 6	-122 3	-163 5	-202 9	-282 7	-241.4	-159 2	-141 9	-142 9
State/local surpl./def.		38.4	44 8	25 1	17 0	24 8	26 3	26 1	29.7	32.5
Ex. social ins. funds		-18 4	-17 5	-35 6	-46 5	-41 6	-40.0	-39 5	-34 8	-31 5
PRICES AND COSTS										
GDP implicit deflator	% change	4 2	4 4	4 5	3 3	2 6	1 8	2 4	2 5	2.5
GDP fixed-wt. price index		4 2	4.4	4.6	3.6	3 2	2.8	2.8	3 0	3.0
Gross domestic purchases fixed-wt. price index		4.1	4 4	5.2	2.9	3.2	2 5	2.9	3.0	3 0
CPI		4 3	4 6	6 3	3.0	3 1	2.7	2.7	2.9	3 1
Ex food and energy		4 5	4 4	5 3	4.4	3.5	3.1	2 8	3 2	3 3
ECI, hourly compensation[2]		4 8	4 8	4.6	4 4	3.5	3.6	3 3	3 7	4 0
Nonfarm business sector										
Output per hour		5	-1.4	4	2.3	3.2	1 8	1 1	7	1.5
Compensation per hour		3 8	3 1	6 2	4 7	5.1	2.4	3.4	4 0	4.3
Unit labor cost		3 3	4 6	5.7	2.3	1 9	6	2 1	3.3	2 8

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)

January 25, 1995

Item	Unit	1992				1993				1994	
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
EXPENDITURES											
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
EMPLOYMENT AND PRODUCTION											
Nonfarm 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	9	5.8	3.4	6.2	5.1	7	3.3	5.3	7.1	6.0
Capacity util. rate-mfg.[1]	%	78.4	79.1	79.4	80.1	80.8	80.6	80.7	81.4	82.3	83.1
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	14.76
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
ECI, hourly compensation[2]		3.6	3.2	3.2	3.5	3.9	3.8	3.4	3.4	2.7	3.7
Nonfarm 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.

Strictly Confidential (FR)
Class II FOMC

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

January 25, 1995

Item	Units	1994		Projected 1995				Projected 1996			
		Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
EXPENDITURES											
Nominal GDP	Bill. $	6791.7	6904.0	7011.8	7089.6	7160.7	7232.1	7315.3	7405.6	7500.1	7595.4
Real GDP	Bill. 87$	5367.0	5433.0	5476.0	5503.6	5527.2	5551.0	5579.1	5614.3	5651.0	5687.8
Real GDP	% change	4.0	5.0	3.2	2.0	1.7	1.7	2.0	2.5	2.6	2.6
Gross domestic purchases		4.4	5.3	3.6	2.7	1.7	1.4	1.7	2.4	2.6	2.5
Final sales		4.3	4.7	4.0	2.7	2.4	2.3	2.3	2.7	2.7	2.8
Private dom. final purch.		4.1	6.7	5.2	4.2	2.9	2.5	2.6	3.0	3.1	3.1
Personal cons. expend.		3.1	4.4	4.0	2.8	2.2	2.1	2.1	2.4	2.5	2.5
Durables		5.8	19.4	7.0	4.3	.6	1.3	9	2.9	3.6	3.5
Nondurables		3.3	1.5	3.6	2.7	2.6	2.2	2.2	2.2	2.2	2.2
Services		2.2	2.3	3.3	2.4	2.4	2.3	2.3	2.4	2.4	2.4
Business fixed invest.		14.1	22.0	11.6	13.1	7.9	6.5	6.7	6.7	6.6	6.5
Producers' dur. equip		18.1	23.9	11.9	14.2	8.0	6.1	6.1	6.0	6.0	6.0
Nonres. structures		1.6	15.5	10.6	9.6	7.7	8.1	8.8	9.0	8.8	8.5
Res structures		-6.0	4	4.6	-1.2	-2.0	-3.5	-2.1	.2	.4	1.2
Exports		14.8	15.1	6.2	7.9	7.5	8.4	8.9	9.2	9.3	9.6
Imports		15.6	15.4	8.8	11.4	6.4	5.2	5.8	7.0	7.9	8.0
Government purchases		6.7	-3.1	1.0	-1.0	-.1	-1.1	-1.0	2	5	8
Federal		10.9	-12.2	-1.7	-7.1	-4.8	-6.0	-7.0	-3.9	-3.2	-2.3
Defense		12.8	-18.3	-1.8	-10.1	-6.7	-3.0	-4.7	-5.3	-4.2	-3.7
State and local		4.3	2.5	2.5	2.5	2.5	1.5	2.2	2.3	2.4	2.4
Change in bus invent	Bill 87$	57.1	61.5	51.0	42.7	33.4	26.4	22.8	20.3	19.1	16.6
Nonfarm		47.4	53.8	46.0	39.7	31.4	24.1	20.5	18.0	16.7	14.2
Net exports		-117.0	-121.7	-128.5	-137.8	-137.9	-134.3	-130.7	-129.1	-129.1	-128.6
Nominal GDP	% change	6.2	6.8	6.4	4.5	4.1	4.0	4.7	5.0	5.2	5.2
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employ.	Millions	113.9	114.8	115.6	116.3	116.8	117.2	117.5	117.9	118.3	118.7
Unemployment rate[1]	%	6.0	5.6	5.3	5.3	5.4	5.4	5.5	5.5	5.5	5.5
Industrial prod. index	% change	4.9	5.4	6.4	3.3	2.1	1.9	2.2	3.0	3.3	3.4
Capacity util rate-mfg[1]	%	83.6	84.4	85.1	85.1	84.7	84.4	84.1	84.0	84.0	84.1
Housing starts	Millions	1.47	1.50	1.49	1.48	1.46	1.44	1.45	1.46	1.47	1.48
Light Motor Vehicle Sales		14.65	15.43	15.33	15.31	14.90	14.85	14.87	15.02	15.17	15.32
Auto sales in U.S.		9.09	9.24	9.35	9.48	9.10	8.98	9.02	9.07	9.12	9.17
North American prod.		7.09	7.42	7.49	7.61	7.40	7.25	7.27	7.32	7.37	7.42
Other		2.01	1.82	1.86	1.87	1.70	1.73	1.75	1.75	1.75	1.75
INCOME AND SAVING											
Nominal GNP	Bill. $	6779.6	6885.9	6991.1	7062.2	7138.5	7204.4	7287.1	7370.6	7468.3	7558.9
Nominal GNP	% change	5.9	6.4	6.3	4.1	4.4	3.7	4.7	4.7	5.4	4.9
Nominal personal income		5.4	9.2	7.6	5.5	4.2	5.0	5.3	5.1	4.8	6.2
Real disposable income		3.1	7.0	3.3	1.8	1.8	2.1	3.5	1.2	2.3	3.1
Personal saving rate[1]	%	4.1	4.6	4.5	4.2	4.2	4.2	4.5	4.2	4.1	4.2
Corp. profits, IVA&CCAdj	% change	7.2	9	-.1	-8.8	2.4	-5.2	0	9.4	11.8	5.3
Profit share of GNP[1]	%	8.2	8.1	8.0	7.7	7.7	7.5	7.4	7.5	7.6	7.6
Federal govt surpl./def	Bill. $	-154.0	-161.6	-147.2	-136.8	-137.4	-146.2	-153.2	-136.2	-132.0	-150.3
State/local surpl./def		23.9	28.1	31.1	30.9	30.0	26.9	28.3	30.8	34.4	36.4
Ex social ins funds		-41.4	-37.1	-33.8	-33.7	-34.3	-37.3	-35.8	-33.2	-29.6	-27.6
PRICES AND COSTS											
GDP implicit deflator	% change	1.9	1.8	3.1	2.4	2.3	2.3	2.6	2.4	2.5	2.5
GDP fixed-wt. price index		3.0	2.5	3.5	2.9	2.8	2.8	3.1	2.9	3.0	3.0
Gross domestic purchases fixed-wt. price index		3.5	2.5	3.6	2.9	2.9	2.8	3.2	2.9	2.9	2.9
CPI		3.6	2.4	2.9	2.9	3.0	3.0	3.0	3.1	3.1	3.2
Ex. food and energy		2.8	2.3	3.3	3.1	3.1	3.1	3.2	3.3	3.3	3.4
ECI, hourly compensation[2]		3.3	3.5	3.6	3.7	3.7	3.8	3.9	4.0	4.0	4.1
Nonfarm business sector											
Output per hour		2.9	1.0	7	4	9	9	1.2	1.6	1.5	1.5
Compensation per hour		3.0	3.7	4.1	3.8	4.0	4.1	4.6	4.3	4.2	4.3
Unit labor cost		0	2.7	3.3	3.4	3.1	3.2	3.3	2.6	2.6	2.7

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)

January 25, 1995

Item	1992				1993				1994					Projected
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	1991	1992	1993	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	215.0
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	254.5
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	164.3
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	210.6
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	117.6
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	42.8
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	29.5
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	45.3
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	87.5
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	79.0
Nonres. structures	1.1	-.6	-3.5	-2.1	.9	.1	.2	1.2	-4.6	6.9	-21.4	-5.1	2.4	8.5
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	5.5
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	50.7
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	43.1
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	7.6
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	-39.5
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	65.1
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	104.6
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	-6.8
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	-18.6
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	-17.2
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	11.8

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)

January 25, 1995

Item	1994 Q3	1994 Q4	Projected 1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1993	Projected 1994	1995	1996
Real GDP	52.9	66.0	43.1	27.6	23.6	23.8	28.1	35.2	36.7	36.8	157.3	215.0	118.0	136.8
Gross domestic purchases	58.2	70.7	49.8	36.9	23.8	20.1	24.6	33.5	36.7	36.3	201.0	254.5	130.6	131.1
Final sales	55.1	61.5	53.6	35.9	32.9	30.8	31.8	37.7	37.9	39.3	153.1	164.3	153.1	146.6
Private dom. final purch	45.4	73.5	58.0	47.5	33.4	29.7	30.6	35.6	36.8	37.0	205.9	210.6	168.6	140.0
Personal cons. expend.	26.9	39.1	35.6	25.1	19.9	19.5	19.0	22.5	23.5	23.2	102.8	117.6	100.1	88.2
Durables	7.4	24.0	9.4	6.0	.8	1.9	1.3	4.2	5.1	5.1	42.0	42.8	18.1	15.7
Nondurables	9.1	4.1	10.0	7.6	7.3	6.2	6.3	6.3	6.3	6.2	13.8	29.5	31.1	25.1
Services	10.4	10.9	16.2	11.5	11.8	11.4	11.4	12.0	12.1	11.9	47.0	45.3	50.8	47.3
Business fixed invest.	22.1	34.7	19.9	23.0	14.6	12.3	12.8	13.0	13.1	13.1	86.3	87.5	69.8	52.0
Producers' dur. equip	21.5	29.1	15.9	19.3	11.5	9.0	9.1	9.2	9.3	9.4	83.9	79.0	55.7	37.0
Nonres. structures	.6	5.6	4.0	3.7	3.1	3.3	3.6	3.8	3.8	3.8	2.4	8.5	14.1	15.1
Res. structures	-3.6	-.2	2.6	-.7	-1.2	-2.0	-1.2	.1	.2	.7	16.8	5.5	-1.3	-.2
Change in bus. invent.	-2.1	4.4	-10.5	-8.3	-9.3	-7.0	-3.6	-2.5	-1.2	-2.5	4.2	50.7	-35.1	-9.8
Nonfarm	-4.3	6.4	-7.8	-6.3	-8.3	-7.3	-3.6	-2.5	-1.3	-2.5	4.4	43.1	-29.7	-9.9
Farm	2.2	-2.0	-2.7	-2.0	-1.0	.3	.0	.0	.1	.0	-.2	7.6	-5.4	.1
Net exports	-5.2	-4.7	-6.8	-9.3	-.2	3.7	3.5	1.7	.0	.5	-43.7	-39.5	-12.6	5.7
Exports	22.6	23.8	10.5	13.4	13.1	14.8	16.0	16.9	17.3	18.3	34.5	65.1	51.7	68.6
Imports	27.9	28.5	17.2	22.7	13.2	11.1	12.5	15.2	17.3	17.8	78.1	104.6	64.3	62.9
Government purchases	14.9	-7.3	2.3	-2.3	-.3	-2.6	-2.4	.4	1.1	1.8	-9.1	-6.8	-2.9	.9
Federal	8.8	-11.0	-1.4	-6.0	-4.0	-4.9	-5.7	-3.1	-2.5	-1.8	-25.9	-18.6	-16.3	-13.1
Defense	6.9	-11.5	-1.0	-5.8	-3.7	-1.6	-2.5	-2.8	-2.2	-1.9	-23.7	-17.2	-12.1	-9.4
Nondefense	1.8	.5	-.4	-.2	-.3	-3.3	-3.2	-.3	-.3	.1	-2.2	-1.4	-4.2	-3.7
State and local	6.1	3.7	3.7	3.7	3.7	2.3	3.3	3.5	3.6	3.6	16.8	11.8	13.4	14.0

1 Annual changes are from Q4 to Q4

Strictly Confidential (FR)
Class II FOMC

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

January 25, 1995

Item	Fiscal year				1994				1995				1996			
	1993[a]	1994[a]	1995	1996	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1153	1257	1348	1407	289	363	318	308	297	407	337	320	309	425	352	332
Outlays[1]	1409	1461	1532	1576	348	363	372	381	392	375	384	391	398	392	393	414
Surplus/deficit[1]	-255	-204	-184	-169	-59	0	-54	-74	-95	32	-47	-71	-89	33	-41	-82
On-budget	-301	-259	-252	-232	-66	-33	-56	-87	-104	-7	-54	-78	-97	-8	-49	-87
Off-budget	46	56	68	63	8	33	2	13	9	39	7	7	8	41	7	5
Surplus excluding deposit insurance[2]	-283	-211	-203	-181	-65	3	-57	-78	-101	29	-53	-73	-94	32	-46	-81
Means of financing																
Borrowing	249	185	191	171	51	8	37	60	76	7	49	50	65	15	40	60
Cash decrease	6	17	-24	0	5	-6	15	9	2	-36	0	25	20	-45	0	25
Other[3]	0	1	13	-2	2	-2	1	1	17	-4	-2	-4	4	-4	1	-3
Cash operating balance, end of period	53	36	60	60	45	51	36	27	24	60	60	35	15	60	60	35
NIPA FEDERAL SECTOR					Seasonally adjusted, annual rate											
Receipts	1242	1355	1464	1524	1338	1381	1389	1418	1461	1484	1491	1502	1505	1538	1553	1574
Expenditures	1497	1529	1610	1666	1514	1526	1543	1580	1609	1621	1628	1649	1658	1674	1685	1725
Purchases	447	439	436	425	438	435	444	435	441	435	432	427	426	424	423	422
Defense	307	296	288	282	292	292	301	289	293	287	284	283	284	282	280	279
Nondefense	140	144	147	143	146	144	144	146	148	148	148	144	142	142	142	143
Other expenditures	1049	1090	1174	1242	1076	1091	1099	1145	1168	1187	1197	1221	1232	1251	1262	1302
Surplus/deficit	-254	-174	-146	-142	-176	-145	-154	-162	-147	-137	-138	-146	-153	-136	-132	-150
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-211	-164	-175	-168	-158	-140	-161	-184	-179	-170	-168	-174	-178	-162	-159	-179
Change in HEB, percent of potential GDP	-.1	-.7	.2	-.1	-.6	-.3	.3	.3	-.1	-.1	0	.1	.1	-.2	0	.3
Fiscal impetus (FI), percent, cal year	-4.1	-7.2	-6.6	-9.2	-4.2	-4.3	3.4	-3.5	-1.5	-2.5	-.5	-4.5	-3.8	-1.8	.1	-.4

1 Excluding health reform, OMB's July 1994 deficit estimates are $167 billion in FY95 and $179 billion in FY96 CBO's January 1995 deficit estimates are $176 billion in FY95 and $207 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 $185 billion in FY95 and $187 billion in FY96 CBO's January 1995 deficit estimates, excluding deposit insurance spending, are $192 billion in FY95 and $216 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 2.4 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

Short-term interest rates generally have registered mixed changes over the intermeeting period. The absence of a hike in the federal funds rate after the December FOMC meeting tended to confirm market expectations that the financial problems of Orange County, coupled with those of Mexico and the possibility of year-end funding pressures, would delay additional tightening. However, with the economy still appearing strong, the market evidently continues to anticipate an appreciable firming over the next few quarters, including a 50 basis point step at the upcoming meeting. Most intermediate- and long-term Treasury rates have edged up a few basis points since late December. Major equity market indexes are up 1-1/2 to 5 percent, as corporate earnings surprises have generally been positive.

M2 advanced at a 1-1/2 percent annual rate in December, while preliminary data for January suggest faster growth. It closed out the year at the lower end of its 1994 target range of 1 to 5 percent. Recent growth may have benefitted a bit from the evident pullback by households from bond and stock mutual funds. However, the impact of this shift on M2 likely has been limited by direct investments in securities, which have remained strong.

Growth of M3 spurted to a 3 percent annual rate in December--ending the year only slightly below the mid-point of its 0 to 4 percent annual target range--and appears to have strengthened further this month. The acceleration of M3 has reflected both the underlying strength of M2 and continued expansion of large time deposits, which banks used along with nondeposit sources to fund large advances in bank credit.

Bank credit accelerated to a 9-1/2 percent pace in December, as loan growth picked up and the runoff of securities holdings slowed considerably. Partial data for early January suggest that brisk credit expansion has continued. Within the loan portfolio, all major categories--business, real estate, and consumer--registered healthy gains in December and early January.

Public bond issuance by nonfinancial firms remained light in December and shows no signs of picking up this month. Corporations continue to prefer to borrow from banks and finance companies, where in both cases loans grew at double-digit rates last year; business loans at banks continue to be readily available as bankers report further easing of standards and terms. Firms also have tapped the commercial paper market in volume in recent months, in many cases to finance mergers. While quality spreads for the most part remain near the low end of their range of the past ten years, spreads did widen on the lowest-rated bonds in December, and that movement has not yet been reversed. Only one speculative-grade bond issue has been brought to market thus far this month, although signs of a turnaround in flows to junk bond mutual funds suggest that demand may be bolstered.

In December, gross equity issuance by nonfinancial firms declined to less than half its November volume, and it has remained weak in January. Stock retirements associated with mergers and share repurchase programs have been outpacing new offerings, and the outstanding volume of corporate equity shares contracted sharply in the fourth quarter.

Household demands for credit remained substantial through the end of the year. Growth of consumer installment debt picked up a bit further in November to a 17 percent annual rate, paced by rapid growth of both auto loans and revolving credit. Helping to sustain the strong growth of auto loans has been the sluggish response so far of loan rates to the rise in market interest rates. Judging from data for commercial banks, consumer credit probably remained strong through December and early January. Preliminary data indicate that home mortgage credit continued to expand appreciably in the fourth quarter, albeit at somewhat below its third-quarter pace. Although separate fourth-quarter data for commercial real estate and home mortgage lending at banks are not yet available, figures on total real estate loans at banks indicate that lending remained brisk in the fourth quarter; this perhaps reflected some further commercial lending, but it most likely indicates that banks continued meeting the considerable demand for adjustable-rate mortgages.

The ratio of tax-exempt to taxable bond yields declined over the intermeeting period, retracing its sharp rise over November and early December. The orderly liquidation and restructuring of the Orange County investment portfolio, plus the apparent absence of serious financial problems of that sort in other jurisdictions, have provided some measure of comfort to the markets for municipal as well as agency and mortgage debt. The improved tone of the municipal market, however, likely also reflects a further net reduction in outstanding long-term debt in 1994, the first such yearly decline on record. In December, retirements of long-term tax-exempt issues were about twice the volume of new issues, and this pattern probably continued in January.

In the federal sector, the Treasury will supplement its first-quarter borrowing with a decrease in its cash balance of $2 billion to help meet the projected deficit of $95 billion. With a thirty-year issue included in the upcoming mid-quarter refunding, the

Treasury is expected to raise through bill issuance only a little over half of its first-quarter total net borrowing of $76 billion.

Outlook

The economic forecast this time assumes that the federal funds rate will be held at 5-1/2 percent through the end of 1996. But, even with this lower rate path, the staff expects GDP growth to slow more, and inflation to pick up less, than the "consensus" private forecast. This suggests that there is a good chance bond yields would ease appreciably later this year. Fiscal policy developments could materially affect market expectations, but in the scenario we have adopted, investors would still have grounds for skepticism that a balanced budget is assured for 2002. Consequently, the assumed fiscal actions provide only a moderate lift to bond prices, and as the economy reaccelerates in 1996, long rates push back up. In many respects, the circumstances in the markets in late 1996 would resemble those now, with a 5-1/2 percent funds rate, and the prospect that inflation would be moving up in the absence of Fed tightening--but core inflation would already be running above 3 percent.

Growth of M2 and M3 is expected to pick up noticeably this year, despite reduced growth of nominal income and depository credit. M2 should be lifted as rates on deposits and money market mutual funds continue to rise in lagged response to previous increases in short-term market rates. As already evident in fourth-quarter data, banks this year also are expected to rely less heavily on nondeposit financing, a source of funds tapped during most of 1994. M2 and M3 should grow a bit faster in 1996, owing to stronger GDP growth, continued narrowing of opportunity costs, and some pickup in depository credit.

Growth in the total debt of domestic nonfinancial sectors is expected to average just over 5 percent both this year and next. Although the unified deficit contracts slightly in calendar years 1995 and 1996, the expansion of federal government debt increases a bit each year owing to changes in the Treasury's cash balance and other means of financing (including checks issued less checks paid, accrued items, and other transactions). Debt growth in the nonfederal sectors holds at slightly above 5 percent over the next two years. Reduced net borrowing by the household sector in both years is offset largely by somewhat higher debt growth of nonfinancial businesses and, to a lesser extent, a resumption of borrowing by the state and local government sector.

In the household sector, total consumer credit growth is expected to fall below last year's rapid pace, as nominal expenditures on consumer durables expand more slowly and the level of repayments on consumer debt extended in recent quarters increases. Home mortgage growth also eases slightly this year and next, as sales of new and existing homes are projected to fall off a bit from last year's pace. Although fixed mortgage rates have held fairly steady since November, the sharp rise in short-term rates over the same period is likely to curb the recent trend toward ARM financing. Despite the rise in household sector debt over the past two years, there has as yet been no indication that consumers have been experiencing financial stress in servicing their debt. Moreover, in the projected economic and financial environment, any upturn in loan delinquency rates should be modest and insufficient to scare lenders into tightening their credit supply to households.

Although inventory accumulation is projected to slow over the next two years, aggregate capital outlays by nonfinancial businesses are expected to move higher. With a flattening of profits damping the growth of internally generated funds, the corporate financing gap widens appreciably in 1995 and 1996. Financing demands will continue to be boosted this year by debt-financed equity retirements associated with merger activity and share buyback programs, although such retirements are likely to taper off in 1996. On balance, corporate debt growth is expected to average nearly 6 percent over the next two years, up from 5 percent in 1994. Business borrowing from banks and finance companies is expected to increase somewhat this year before slowing moderately in 1996, while growth of outstanding commercial paper is expected to decline in each of the next two years. As bond yields move lower later this year, there should be a resurgence in long-term debt issuance, as firms fund out some of the bank loans and short-term paper they have issued. A shift to capital market financing also is likely to be encouraged by an abatement of the swing toward easier nonprice terms and standards in bank business lending.

After contracting moderately last year, state and local government debt is expected to resume expanding in 1995, albeit slightly, and to pick up somewhat more in 1996. The resumption of debt growth reflects a significant slowing in the paydowns of pre-refunded obligations while governments continue borrowing to finance sizable NIPA deficits on capital and operating accounts.

Confidential FR Class II
January 25, 1995

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	7.1	6 4	7.8	0.6	7.1	-0.4	5 0
1994	5.0	4.7	5.2	7.8	6.2	13 0	4.2	-2.4	5.2	6.6
1995	5.2	5.2	5 2	6.5	5 7	9.7	4.8	0.4	1.0	4 8
1996	5 1	4.9	5.2	6.2	5.7	8 2	4.6	3.0	1.0	5.0
Quarter (seasonally adjusted annual rates)										
1994:1	5.3	6.3	4.9	7.1	6.3	8.4	3 5	1.0	9.1	6.1
2	4.5	3.6	4.8	7.3	5.6	13.8	3.8	-2.8	6.4	7.2
3	4.9	3.9	5.2	8.4	6.5	13.9	4.1	-4.9	3.0	6.2
4	5 1	4.5	5.3	7.5	5.9	13 7	4.9	-3 1	1.7	6 8
1995:1	6.3	8.9	5.4	6.9	5.7	11.2	4.9	-0 2	1.5	6.4
2	4.5	3.4	4.9	6.4	5.6	9.4	4.4	-0.1	0.6	4.5
3	5.0	4.9	5.0	6.2	5.6	8.8	4.6	0.8	0.7	4 1
4	4.6	3.2	5.2	6.1	5.5	8 2	5.0	1.3	1.0	4.0
1996:1	5.8	7.5	5.2	6.0	5.5	8.1	4.8	2.3	1.0	4.7
2	4 8	4.1	5.1	6.0	5.6	8.0	4.5	2.8	1.0	5 0
3	4.7	3.7	5.1	6.0	5.6	7 9	4.4	3.3	1 0	5.2
4	4.7	4.1	5.0	6.0	5.6	7.7	4.2	3.3	1.0	5.2

1. Data after 1994:3 are staff projections. Changes are measured from end of the preceding period to end of period indicated except annual nominal GDP growth, which is Q4 to Q4.
2. On a quarterly average basis, total debt growth is projected to be 5.2 percent in 1994, 5.2 in 1995, and 5.2 in 1996. Federal debt rises 5.7 percent in 1994, 5.0 percent in 1995, and 5.0 percent in 1996. Nonfederal debt rises 5 1 percent in 1994, 5.2 percent in 1995, and 5.2 percent in 1996.

2.6.3 FOF

Confidential FR Class II
January 25, 1995

FLOW OF FUNDS PROJECTIONS: HIGHLIGHTS[1]
(Billions of dollars)

		Calendar year				----1994----		----------1995----------				----1996----	
		1993	1994	1995	1996	Q3	Q4	Q1	Q2	Q3	Q4	H1	H2
						-----------Seasonally Adjusted Annual Rates-----------							
	Net funds raised by domestic nonfinancial sectors												
1	Total	649.4	581.0	631.2	686 2	565.3	554.7	755.2	542.5	626.0	601.2	715.8	656.6
2	Net equity issuance	21.3	-40.9	-45.5	-13.0	-50.0	-102.0	-65.0	-50.0	-42.0	-25.0	-15.0	-11.0
3	Net debt issuance	628.1	621.9	676.7	699.2	615.3	656.7	820.2	592.5	668.0	626.2	730.8	667.6
	Borrowing sectors												
	Nonfinancial business												
4	Financing gap[2]	28 9	62.1	137.1	144.5	63.3	109.4	123.8	143.3	139.4	141.9	142 7	146.4
5	Net equity issuance	21.3	-40.9	-45.5	-13.0	-50.0	-102.0	-65.0	-50.0	-42.0	-25.0	-15 0	-11.0
6	Credit market borrowing	21.9	155.6	187.7	186.1	156.4	190.0	191.4	173.4	184.5	201.6	192.1	180.1
	Households												
7	Net borrowing, of which:	284.5	334.6	302.7	303.3	373.5	341.1	318.8	299.7	298.5	293.8	299.8	306.8
8	Home mortgages	178.2	184.4	180.5	189.3	199 5	183.0	179.7	180.1	180.4	181.8	186.3	192.3
9	Consumer credit	62.3	113.0	95.1	88.0	127.1	130 2	110.0	94.2	90.2	86.2	87.7	88.2
10	Debt/DPI (percent)[3]	88.4	89.9	90.6	91.5	91.0	90 7	90.9	91.3	91.6	91.9	91.3	91.7
	State and local governments												
11	Net borrowing	65.7	24.2	4.3	29.0	-48.8	-30.2	-2.2	-1.2	7.8	12.8	25.3	32.8
12	Current surplus[4]	-56.3	-56.2	-41.8	-39.8	-67.8	-43.9	-39.7	-40 4	-41.8	-45.4	-42.7	-36.9
	U.S.government												
13	Net borrowing	256.1	155.9	182.0	180.9	134.1	155.9	312.2	120.6	177.2	118.1	213.7	148.0
14	Net borrowing;quarterly, nsa	256.1	155.9	182 0	180.9	37.0	59.7	75.7	7.3	48.6	50.4	80.7	100.2
15	Unified deficit;quarterly, nsa	226.3	185.8	181.7	179.2	53.5	74.0	95.2	-31.9	47.0	71.4	56.2	123.0
	Funds supplied by												
16	depository institutions	140 2	203.5	193.6	213.0	228.1	233.1	199.4	188.1	189.6	197.3	211.3	214.8
	MEMO: (percent of GDP)												
17	Dom. nonfinancial debt[3]	189.8	188.0	187.0	188.0	188.8	188.1	188.1	188.1	188.6	188.9	188.1	188.1
18	Dom. nonfinancial borrowing	9.9	9.2	9.5	9.4	9.1	9.5	11.7	8.4	9.3	8.7	9.9	8.8
19	U.S. government[5]	4.0	2.3	2.6	2.4	2.0	2.3	4.5	1.7	2.5	1.6	2.9	2.0
20	Private	5.9	6.9	6.9	7.0	7.1	7.3	7.2	6.7	6.9	7.0	7.0	6.9

1. Data after 1994:3 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.

Recent Developments

Since the December FOMC meeting, international financial markets have been dominated by several special developments, most importantly the currency crisis in Mexico and its wider effects but also the weakness of the Canadian dollar and the earthquake in Japan. The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies has depreciated 2-1/2 percent over the intermeeting period.[1] A factor weighing against the dollar has been market concern that the financial crisis surrounding Mexico would limit the scope for further Fed tightening in the face of continuing indicators of strong U.S. economic expansion.

The Mexican peso has depreciated nearly 40 percent against the dollar since the onset of the currency crisis. About one-third of the peso's decline came when the Mexican government announced a devaluation on December 20. Substantial further depreciation took place during the following week after continued downward pressure and heavy reserve losses resulted in the decision to allow the peso to float. Since then the peso has fluctuated widely in a range between 5 and 6 pesos per dollar, buffeted by conflicting signals about the prospects for Congressional passage of a U.S. guarantee program. Three-month interest rates in Mexico have nearly tripled since the crisis began, to 25 percent on dollar-indexed bills (Tesobonos) and about 40 percent on peso-denominated bills (Cetes).

1. On a broader basis, incorporating the currencies of eight key developing countries (Mexico, Chile, Hong Kong, Malaysia, the Philippines, Singapore, South Korea, and Taiwan) as well as the G-10 industrial countries, weighted by their shares in world trade, the dollar has appreciated 1/2 percent during this period. When the eighteen countries are weighted by shares in U.S. non-oil imports, the dollar has appreciated 2-1/2 percent, reflecting the fact that countries whose currencies have depreciated (Mexico and Canada) have a greater weight in U.S. imports than they have in world trade.

Investor uncertainty surrounding developments in Mexico has, to some extent, spilled over to financial markets of other emerging market countries as well as to several industrial countries. In Argentina and Brazil, stock market indexes have declined around 20 percent since December 19, and their Brady bond prices are down about 8 percent. These declines are roughly half the magnitude of the declines in Mexico's stock market (in dollars) and prices of Mexican Brady bonds. Nevertheless, both Argentina and Brazil have been able to hold their currencies steady with moderate increases in short-term interest rates. Asian emerging stock markets are down about 10 percent for the same period, although part of this decline was associated with a drop in the Japanese stock market.

Industrial countries that have been most negatively affected are those with large fiscal or external deficits and/or domestic political uncertainties. Over the past month, the Canadian dollar has declined 2 percent, to a nine-year low, prompting the Bank of Canada to raise short-term rates 150 basis points. In Europe, the Spanish peseta and the Swedish krona have declined 3 to 4 percent against the mark. Short-term interest rates have been tightened 60 basis points in Spain but have been little changed in Sweden. The mark and several other continental European currencies appear to have been buoyed by a "flight to quality," appreciating about 4 percent since the December meeting. The yen rose earlier in the period, but has declined somewhat since the earthquake and is up about 1 percent on balance. Japanese stock price indexes have fallen about 6 percent in the wake of the quake.

. As

part of the exchange stabilization fund set up for Mexico on

January 2, U.S. swap lines to the Bank of Mexico were increased by $3 billion to a total of $9 billion (divided evenly between the System and the Treasury). Canadian swap lines to Mexico were increased to about $1 billion and other BIS countries made available a total of $5 billion. Mexico subsequently drew on its U.S. swap lines on two occasions for a total of $1 billion (split evenly between the System and the Treasury); the first drawing of $500 million was announced publicly by the Mexicans.

The expansion of real economic activity in the major foreign industrial countries appears to have slowed somewhat in the fourth quarter of 1994 from the very rapid pace recorded in most cases in the third quarter. The growth of industrial production decelerated in Europe and Canada during the first part of the quarter. In Japan, the growth of retail sales slowed in October-November and new orders have been sluggish. Japanese output in the first quarter will be affected negatively by the January 17 earthquake. The area around Kobe most severely affected accounts for about 4 percent of Japan's GDP, the broader region affected accounts for another 13 percent, and production and bottlenecks will spill over negatively to output elsewhere in Japan.

Inflation pressures remain subdued in most of the foreign industrial countries although consumer prices appear to have accelerated a bit in the United Kingdom and Italy during the fourth quarter and wholesale price inflation has picked up a little in Germany.

The U.S. nominal trade deficit in goods and services widened somewhat further in the first two months of the fourth quarter. While imports continued to grow faster than exports, the growth rates of both slowed somewhat from their strong third-quarter rates. Inflation of non-oil import prices remained about 5 percent (annual rate) in October-November, reflecting in part the continuing effects of the dollar's depreciation earlier in 1994. Industrial supplies and food imports showed the sharpest price increases. Spot oil prices have risen 9 percent from their depressed levels in mid-December to a level of $18.60 per barrel, partly on stronger-than-expected demand for gasoline.

Outlook

The outlook for the U.S. external sector has been altered primarily by two key developments: events surrounding Mexico and the shift to an assumption of an unchanged federal funds rate over the forecast period. Previously we had projected that net exports would be about unchanged in 1995 and would increase slightly in 1996. As a result of the new developments, we now expect that net exports will decline during 1995 by enough to subtract 1/4 percent from GDP, with much of the decline coming during the first half of the year. Our projection that real net exports will rise slightly in 1996 remains essentially the same as in December, however, as the effects of the new developments tend to cancel each other out next year. The earthquake in Japan is likely to affect primarily the timing of trade flows in the near term, but its effect on U.S. net exports over the forecast period should be small.

With respect to the Mexican situation, the recent disruptions in international financial markets have led to a sharply lower outlook for real growth in Mexico during 1995 and 1996 and to more moderate downward revisions for Argentina and Brazil. In addition, the outlook for GDP growth in Canada has been revised down significantly. These revisions have accounted for a projected 1/2 percentage point reduction in the rate of growth of total foreign GDP (weighted by shares in U.S. exports) over the next two years, to an average annual rate of 3-1/2 percent. The substantial real depreciation of the peso further depresses the outlook for U.S. net exports.

This outlook assumes that the damage associated with Mexico's currency crisis will be successfully contained by a U.S.-led, multilateral rescue program. If such a program were not forthcoming, the resulting further deterioration in the Mexican economy and potential spillover to other emerging markets would magnify the decline in U.S. real net exports.

The change in the U.S. interest rate assumption has a net positive effect through the external sector. Abstracting from the peso, the dollar is projected to be lower than in our previous forecast. The resulting exchange-rate stimulus to net exports is partly offset by stronger imports resulting from the higher U.S. domestic growth induced by the lower interest rate path.

The dollar. We expect that if the federal funds rate were held unchanged, the foreign exchange value of the dollar in terms of the other G-10 currencies would weaken further during the first half of this year and would remain little changed through the rest of the forecast period. We assume that the peso will regain some of its recent losses later this year but that over the next two years it will average about 20 percent lower in real terms than we assumed in the December Greenbook. We also expect the dollar to depreciate moderately on balance in real terms against the currencies of Asian developing countries through 1996. Overall, the average projected level of the dollar in real terms against eighteen currencies is somewhat lower than in our previous forecast when weighted in terms of world trade shares and about the same as in the previous forecast when weighted by U.S. non-oil import shares.[2]

2. The index weighted by world trade shares is used to forecast U.S. exports and that weighted by non-oil import shares is used to forecast U.S. imports.

Foreign G-7 countries. Real GDP growth in the foreign G-7 countries (weighted by U.S. exports) is projected to average a little more than 3 percent through the end of the forecast period, somewhat less than projected in the December Greenbook. This revision reflects a reduction of 3/4 percentage point in the Canadian forecast for 1995 and 1996 and small offsetting changes elsewhere. In our forecast, neither the financial crisis surrounding Mexico nor the earthquake in Japan has much net implication for growth over the next two years in Europe and Japan.[3]

We expect Canadian GDP growth will slow from its recent very strong pace albeit to a rate still somewhat above potential. Some slowing had been anticipated in view of the outlook for declining U.S. growth. The recent runup in Canadian interest rates and the anticipated austere federal budget to be released in February should further damp Canadian growth.[4]

Our outlook for Japanese GDP growth has changed as well but largely only regarding its timing. While the damage from the earthquake and its implications are still being assessed, we have assumed that the disruption of transportation, production, and port facilities in the Kobe-Osaka region will knock 1 percentage point off Japan's GDP growth (annual rate) in the first quarter. In subsequent quarters, reconstruction of lost capital (estimated to be

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3. Developments in Canada and Mexico affect primarily the United States, the dominant trading partner for both of these countries. The earthquake has significant implications for the timing and composition of Japan's GDP growth but not for its overall magnitude over the next year or two, as discussed below.

4. The depressing effect of the recent 150-basis point increase in Canadian short-term interest rates is partly offset by the stimulative effect of the 2 percent depreciation of the dollar. The Bank of Canada's monetary conditions index, which weights these two variables according to their effects on real activity, puts a weight of 0.25 on the exchange rate and 0.75 on short-term interest rates. Thus, the 2 percent depreciation offsets about 67 basis points of the interest rate increase.

roughly 1 percent of GDP) should result in a small net increases in GDP growth for 1995 and 1996. Current estimates of substantial excess capacity in Japan could mean that both the initial loss in production and the rebuilding may be mitigated to some extent.

Elsewhere, our outlook is little changed. In Germany, where real GDP now appears to be close to potential levels, growth is expected to slow to near potential rates over the forecast period. The income tax surcharge that took effect at the beginning of the year should slow growth in German consumption this year, and an anticipated firming of monetary policy should restrain activity a bit next year. In France, Italy, and the United Kingdom, growth is expected to continue exceeding potential and to bring GDP within 1 percent or so of potential levels by the end of 1996.

Consumer price inflation in the foreign G-7 countries is projected to remain low but to rise somewhat over the forecast period as continued stronger activity reduces the slack in those economies. On average, inflation in these six countries (weighted by U.S. import shares) is projected to increase from about 1-1/4 percent in 1994 to about 1-3/4 percent in 1995 and 1996.

Our forecast assumes that foreign short-term interest rates on average will increase over the next two years as most central banks react to the stronger activity in their respective economies; short-term rates are expected to rise about 1 percentage point over the forecast period, with rates moving up more in Germany--where the margin of slack appears to be smaller--than elsewhere. Canada is an exception to this pattern. Short-term real rates are already high in Canada, and we expect that they will recede somewhat as growth slows.

Foreign long-term rates, on average, are expected to change little through the end of the forecast period in light of the persistence of favorable inflation performance.

Other countries. The real GDP of major trading partners of the United States in the developing world (weighted by U.S. nonagricultural export shares) is forecast to increase 4-3/4 percent in 1995 and by 4-1/2 percent in 1996. The aggregate growth outlook for developing countries has been revised downward about 3/4 percent in 1995 and 1 percent in 1996, reflecting a large downward revision for Mexico and smaller reductions for Brazil and Argentina.

We are now projecting GDP in Mexico to be zero in 1995 and 1 percent in 1996, down from our previous projections of 3-3/4 and 4-1/2 percent respectively.[5] The primary factors depressing the growth outlook are: (1) fiscal and monetary contraction associated with the program that the Mexican government will likely implement over the medium term, (2) the substantially higher cost to Mexican consumers and investors of borrowing abroad, and (3) the negative effect on investment of increased investor uncertainty. These negative effects will be partly offset by the stimulus to Mexico's net exports from the substantially lower level of the peso in real terms. The lower growth of Mexican GDP that we are now projecting and our assumption that the peso will stabilize at 5 pesos per dollar imply that Mexico's current account deficit will narrow to \$13 billion in 1995 and \$5 billion in 1996 (the deficit in 1994 was an estimated \$27 billion). Our assumption that GDP growth will begin to recover, albeit slowly, during 1996 is based in part on the assumption that the high risk premiums now imbedded in Mexican interest rates will decline in part as a result of the passage of

5. The latest Mexican government forecast puts Mexican growth at 1-1/2 percent in 1995.

the U.S. guarantee program. The Mexican situation clearly remains fluid, and therefore, the judgments embodied in our forecast are highly tentative.

Assuming that Mexico's currency crisis is contained, fallout on other major countries in Latin America--particularly Argentina and Brazil--is expected to be limited. Neither Brazil nor Argentina has significant trade ties with Mexico; their primary exposure to the crisis is through investor confidence and movements in interest rates. Argentina's growth forecast has been revised downward 1/2 percentage point in 1995 and 1-1/2 percentage points in 1996, and Brazil's somewhat less, as higher interest rates have depressed the outlook for investment demand in both countries.

The growth outlook for major developing countries in Asia in 1995 has been strengthened about 1/4 percentage point. This increase reflects the upward revision to U.S. growth and indications that output capacity is expanding more rapidly in these countries than previously thought.

U.S. real net exports. Real net exports of goods and services are expected to decline $13 billion in 1995 (about one-third the rate of decline expected for 1994) and to increase slightly in 1996.

We expect that export growth will slow somewhat during 1995 as shipments to Mexico drop off but will nevertheless grow strongly overall, sustained by the strong pace of GDP growth elsewhere and the lagged effects of the decline in the dollar during 1994.[6]

We project the growth of non-oil imports other than computers to slow to less than 4 percent during 1995 and to pick up a bit in 1996. This path reflects the projected slowing of U.S. GDP growth and the lagged effects (especially during 1995) of the recent

6. External adjustment in Mexico is expected to cut real exports of U.S. goods and services $6 billion (AR) in the first half of 1995 and an additional $6 billion or so by the end of 1996.

QUANTITIES OF GOODS AND SERVICES*
(Percent change from end of previous period, SAAR)

	1993	1994 H1	1994 Q3	1994 Q4	Projection 1995	Projection 1996
Exports	5.8	6.1	14.8	15.1	7.5	9.2
Services	5.0	2.7	5.4	5.2	4.1	4.7
Computers	23.1	14.8	37.7	38.7	29.2	26.2
Other goods 1/	4.5	7.3	12.2	12.2	4.8	6.9
Imports	12.4	14.1	15.6	15.4	7.9	7.2
Services	8.7	-0.4	5.7	10.9	3.7	3.2
Oil	10.0	7.7	29.3	-36.3	8.1	0.5
Computers	38.3	27.7	35.8	60.5	27.8	21.6
Other goods 2/	9.3	15.7	12.1	15.4	3.8	4.3

* NIPA basis, 1987 dollars.
1. Nonagricultural exports of goods excluding computers.
2. Non-oil imports of goods excluding computers.

increase in import price inflation. The recent earthquake's disruption of port and transportation facilities in the Kobe area is expected to reduce U.S. imports from Japan about $3 billion (AR) in the first quarter. We assume this shortfall will be made up during the second and third quarters. The very rapid growth of computer imports, which currently have a weight in total real imports of about 20 percent, significantly boosts the growth of total imports over the forecast period. We expect the quantity of oil imports to remain on an upward trend as U.S. oil consumption increases in line with economic activity and domestic oil production recedes further.

Oil prices. The outlook for oil import prices has been revised upward slightly in the near term because of the recent firming of spot prices, but our longer-term outlook for oil prices remains unchanged. We expect the WTI to fall a bit in the near term and then to return to $18.50 per barrel by June 1995, and remain unchanged through 1996. The U.N. sanctions against Iraqi oil exports remained in place at this month's sanction review, and we assume that Iraq will not return to the world oil market until 1996.

Prices of non-oil imports and exports. The increase in prices of non-oil imports excluding computers is expected to slow during

SELECTED PRICE INDICATORS
(Percent change from end of previous period except as noted, AR)

	1993	1994 H1	1994 Q3	1994 Q4	Projection 1995	Projection 1996
US PPI 1/	0.9	2.8	5.7	3.4	3.7	2.3
Nonag. exports 2/	0.7	3.2	6.1	4.0	3.1	2.0
Non-oil imports 2/	1.3	2.1	6.2	5.4	3.9	2.4
Oil imports (Q4 level, $/bl.)	14.09	14.67	16.22	15.44	16.00	16.00

1. Selected categories (ex computers) weighted by U.S. exports.
2. Excluding computers.

1995 and to decelerate further in 1996 as the effects of last year's depreciation of the dollar and rapid increase in commodity prices recede. In the absence of further supply shocks, we are projecting that commodity prices will rise much less rapidly in real terms than they did during 1994. Nonagricultural export price increases are expected to slow over the forecast period.

Nominal trade and current account balances. The trade deficit on goods and services is projected to widen somewhat further during 1995 and remain little changed in 1996. The deficit on net investment income is projected to increase, reflecting the path of interest rates and rising U.S. net international indebtedness. We expect that, as a result of these developments, the current account deficit will average about $195 billion in 1995 and 1996, 2.6 percent of GDP and approximately $40 billion larger than our estimate for 1994.

STRICTLY CONFIDENTIAL - FR
CLASS II FOMC

January 25, 1995

REAL GDP AND CONSUMER PRICES, SELECTED COUNTRIES, 1993-96
(Percent; quarterly change at an annual rate except as noted)

								Projected			
		Projected			1994			1995			
Measure and country	1993	1994	1995	1996	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP											
Canada	3.2	5.0	3.4	3.0	6.7	4.7	4.3	3.8	3.6	3.2	3.2
France	-0.5	3.4	3.4	3.7	4.5	3.3	2.5	3.2	3.3	3.4	3.6
Germany	-0.1	4.1	2.8	3.0	4.5	5.3	3.7	2.9	2.7	2.7	2.9
W. Germany	-0.5	3.6	2.3	2.5	4.0	5.3	3.0	2.2	2.2	2.3	2.4
Italy	0.4	2.4	4.0	3.0	4.8	4.0	0.0	4.0	5.0	4.0	3.0
Japan	-0.5	2.5	2.8	3.5	0.7	3.7	2.3	1.5	2.6	3.4	3.5
United Kingdom	2.7	4.0	3.1	2.8	5.5	3.2	3.1	3.2	3.2	3.0	3.0
Average, weighted by 1987-89 GDP	0.5	3.3	3.1	3.2	3.6	3.9	2.5	2.8	3.2	3.3	3.3
Average, weighted by share of U.S. nonagricultural exports											
Total foreign	2.8	4.4	3.5	3.6	NA	NA	NA	NA	NA	NA	NA
Foreign G-7	1.7	4.1	3.2	3.1	4.9	4.2	3.4	3.1	3.3	3.2	3.3
Developing countries	5.9	5.9	4.4	4.8	NA	NA	NA	NA	NA	NA	NA
CONSUMER PRICES(1)											
Canada	1.8	0.0	1.8	2.1	-1.4	2.2	1.3	1.5	1.6	2.0	2.0
France	2.1	1.6	1.6	1.5	2.5	0.6	1.7	1.8	1.5	1.5	1.4
Western Germany	3.7	2.8	2.3	2.7	2.7	1.4	1.3	4.2	2.8	1.0	1.3
Italy	4.1	3.8	4.2	4.4	3.4	3.0	4.7	4.6	4.5	3.6	4.1
Japan	1.2	0.8	0.9	0.7	1.3	-0.9	2.1	1.5	0.7	0.4	1.1
United Kingdom	1.6	2.6	3.5	3.9	7.4	0.1	2.6	2.8	7.4	1.5	2.6
Average, weighted by 1987-89 GDP	2.2	1.8	2.1	2.2	2.6	0.6	2.3	2.6	2.7	1.4	1.9
Average, weighted by share of U.S. non-oil imports	1.9	1.1	1.7	1.8	1.1	0.7	1.9	2.0	1.9	1.3	1.7

Note. Annual values are measured from Q4 to Q4.
1. Not seasonally adjusted.

Strictly Confidential (FR) Class II-FOMC

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	-151.6	-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	-106.6	-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	-166.5	-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	59.9	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	-11.2	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	43.5	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	-54.7	-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	-33.8	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				Projection 1996				Projection ANNUAL		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1994	1995	1996
NIPA Real Net Exports of Goods & Services (87$)	-117.0	-121.7	-128.5	-137.8	-137.9	-134.3	-130.7	-129.1	-129.1	-128.6	-113.6	-134.6	-129.4
Exports of G&S	666.5	690.3	700.8	714.2	727.2	742.0	758.1	775.0	792.3	810.6	655.1	721.1	784.0
Goods	505.1	526.8	537.3	548.5	559.5	571.9	585.8	600.7	616.1	632.5	495.2	554.3	608.8
Agricultural	40.7	44.0	43.3	43.2	43.0	43.1	43.3	43.5	43.7	43.9	39.7	43.2	43.6
Computers	85.9	93.2	100.2	107.2	113.7	120.5	127.7	135.4	143.5	152.1	83.8	110.4	139.7
Other Goods	378.5	389.6	393.7	398.1	402.9	408.3	414.8	421.8	428.9	436.5	371.7	400.7	425.5
Services	161.3	163.4	163.4	165.6	167.7	170.1	172.2	174.2	176.1	178.0	159.8	166.7	175.1
Imports of G&S	783.5	812.0	829.2	851.9	865.2	876.3	888.8	904.1	921.4	939.2	768.7	855.7	913.4
Goods	674.6	700.3	715.4	736.6	749.5	760.5	772.5	786.8	803.0	819.6	659.6	740.5	795.5
Oil	64.3	57.4	57.7	60.1	61.2	62.1	61.8	62.2	62.6	62.4	59.6	60.3	62.3
Computers	115.4	129.9	140.7	149.5	157.8	166.0	174.3	183.0	192.1	201.7	113.0	153.5	187.8
Other Goods	494.9	512.9	517.0	527.0	530.5	532.4	536.4	541.6	548.3	555.5	486.9	526.7	545.4
Services	108.9	111.8	113.9	115.4	115.7	115.9	116.4	117.3	118.4	119.6	109.1	115.2	117.9
Memo:(Percent change 1/)													
Exports of G&S	14.8	15.1	6.2	7.9	7.5	8.4	8.9	9.2	9.3	9.6	10.4	7.5	9.2
Agricultural	38.8	37.2	-6.3	-1.0	-2.6	1.4	1.9	1.9	1.8	1.8	12.7	-2.1	1.8
Computers	37.7	38.7	33.5	31.1	26.2	26.2	26.2	26.2	26.2	26.2	26.0	29.2	26.2
Other Goods	12.2	12.2	4.3	4.5	4.9	5.5	6.5	6.9	6.9	7.2	9.7	4.8	6.9
Services	5.4	5.2	0.1	5.4	5.2	5.8	5.0	4.7	4.4	4.5	4.0	4.1	4.7
Imports of G&S	15.6	15.4	8.8	11.4	6.4	5.2	5.8	7.0	7.9	8.0	14.8	7.9	7.2
Oil	29.3	-36.3	2.0	17.3	7.6	6.1	-1.7	2.6	2.5	-1.2	-1.1	8.1	0.5
Computers	35.8	60.5	37.6	27.7	23.9	22.5	21.6	21.6	21.6	21.6	37.3	27.8	21.6
Other Goods	12.1	15.4	3.2	8.0	2.7	1.4	3.0	4.0	5.0	5.4	14.7	3.8	4.3
Services	5.7	10.9	7.8	5.2	1.2	0.5	1.8	3.1	4.0	4.1	3.9	3.7	3.2
Current Account Balance	-166.9	-183.8	-183.2	-199.1	-195.6	-205.8	-193.4	-197.5	-192.5	-204.4	-157.9	-195.9	-196.9
Goods & Serv (BOP), net	-118.0	-121.4	-126.8	-136.0	-137.6	-133.4	-129.0	-126.3	-124.6	-122.7	-110.8	-133.5	-125.6
Goods (BOP), net	-178.5	-181.5	-185.8	-197.2	-201.0	-199.5	-197.6	-196.9	-197.2	-197.2	-168.6	-195.9	-197.2
Services (BOP), net	60.5	60.1	59.0	61.1	63.4	66.1	68.6	70.7	72.6	74.5	57.8	62.4	71.6
Investment Income, net	-15.8	-21.9	-24.4	-31.1	-26.0	-31.4	-31.9	-38.7	-35.4	-40.2	-13.0	-28.2	-36.6
Direct, net	41.1	44.0	42.8	43.1	46.9	49.6	50.0	49.7	51.5	54.5	43.6	45.6	51.4
Portfolio, net	-56.9	-65.9	-67.2	-74.2	-72.9	-81.0	-81.9	-88.4	-86.9	-94.7	-56.6	-73.8	-88.0
Unilateral Transfers, net	-33.1	-40.5	-32.0	-32.0	-32.0	-41.0	-32.5	-32.5	-32.5	-41.5	-34.0	-34.2	-34.8

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