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Strictly Confidential (FR) Class II FOMC

May 17, 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

Although a few surprises have popped up in the incoming data since the last Greenbook, they have not been such as to cause us to alter the basic contours of our baseline projection. The forecast presented herein--built on the assumption of a stable federal funds rate--still shows a period of sluggish economic growth, during which inventory investment moderates, followed thereafter by GDP expansion around the trend rate of potential output growth. On net, real GDP is projected to rise a shade more than 2 percent this year and just under 2-1/2 percent during 1996. The unemployment rate remains around 5-3/4 percent through next year, and inflation at the consumer level runs in the vicinity of 3 percent.

Perhaps the most important surprise recently was the plunge in auto sales in April, which has prompted an even deeper cutback in motor vehicle production than was anticipated in the last Greenbook. Restrained in large part by the cut in auto assemblies, growth of real GDP is expected to be held to a gain of only about 1 percent at an annual rate this quarter. Nonetheless, financial market conditions generally appear conducive to sustained expansion in domestic final demand. Notably, as indications of a slackening in activity have emerged, bond markets have rallied, pushing long-term rates sharply lower and providing added lift to equity prices as well. Moreover, export trends appear likely to be quite favorable at current exchange rates. Thus, an inventory adjustment of the magnitude that seems in prospect should not derail the current economic upswing.

The step-up in the rate of rise of the core CPI over the past few months has reversed the low readings of late last year and moved the twelve-month change up to 3.1 percent; however, we expect little further pickup in this measure of inflation during the forecast period. Labor costs remain under remarkable restraint, and the current easing of pressures on industrial capacity should help slow the rise in materials costs in coming months. The steep decline of the dollar against the yen and some European currencies since the start of the year will leave its imprint on the prices of autos and some other goods; but with the depreciation of the dollar much more limited on a trade-weighted basis, we anticipate only a little pressure from imported inflation overall. All told, the increase in the core CPI is projected at 3 1/4 percent this year and a shade less in 1996.

Key Assumptions

As noted above, we have retained our previous baseline assumption that the federal funds rate will be held near 6 percent through the end of 1996. Forward rates point to flatness--if not some easing--in the funds rate over the balance of the year, rather than the moderate increases that were built into the term structure a couple of months ago. Longer-term rates are now at considerably lower levels than we anticipated would be reached this year or next. However, given the underlying trends in aggregate saving and investment, we believe that the momentum of the recent bond rally has pushed intermediate- and long-term rates below levels that are sustainable. In the forecast, as growth of final demands for goods and services displays reasonable momentum and the prospect of Fed easing grows more remote, the yield curve is expected to steepen somewhat.

Of course, anything said at this time about the fiscal outlook is highly conjectural. The budget committees of both houses have now passed resolutions calling for elimination of the federal deficit by fiscal year 2002, but the process of reaching an agreement on the details of the proposals--especially one that is acceptable to the Administration or that is veto-proof--will likely take several months. As in the last Greenbook, our working assumption is that legislation will be enacted embodying deficit reduction of about $20 billion in fiscal 1996 and another increment of $30 billion in fiscal 1997. A smooth path to budget balance by 2002 would require deeper cuts in the next couple of years - something more akin to what is specified in the congressional budget proposals. However, our expectation is that the compromise eventually reached will involve a stretching out of the timetable or a backloading of the restraint--either of which makes a further, major anticipatory bond market effect unlikely. On the possibility that we are being too cautious in our assumptions about fiscal restraint, we also present, at the end of this section, an alternative simulation that incorporates considerably larger cuts in the federal budget deficit over the near term.

The outcome of the fiscal debate is potentially of some importance to participants in foreign exchange markets. While greater fiscal restraint would, all other things equal, point toward lower domestic interest rates and a weaker dollar, the behavior of exchange rates in recent days suggests that short-run effects on the dollar could run in the opposite direction. Market participants perhaps are reassessing the "risk premia" associated with concerns about the ability of the U.S. government to manage its fiscal affairs and avert longer-range economic instability. As it is, gyrations of the dollar have left its average trade-weighted value against other G-10 currencies little changed on net from what it was at the time of the last Greenbook, and we continue to anticipate that the dollar will fluctuate around the current level through 1996.

Our expectations regarding other aspects of the external sector have also changed little since March. Foreign GDP growth is projected at about 3 percent in 1995 and 3-1/2 percent in 1996--off from the 4-1/4 percent pace of last year. Activity in Mexico is predicted to continue declining through most of 1995 and then to turn up in 1996; however, we believe that the steepest part of the drop in that country's GDP is occurring in the first half of this year and that the most negative effects on the growth of our net exports to Mexico may already have passed. The aggregate current account deficit of the United States is expected to widen to about $200 billion at an annual rate by the end of 1995, before narrowing slightly in 1996 as lagged exchange rate effects contribute to a significant positive swing in real net exports. We expect the recent upswing in world oil prices to be transitory; by the fourth quarter, the spot price of West Texas intermediate, which moved above $20 a barrel for a brief time early this spring, is expected to drop back to $18.50 a barrel late this year, the same level as was forecast in the last Greenbook.

In the credit markets, we continue to think that the "tailwinds" that arose last year as banks became more aggressive lenders will dissipate. The shift back in lending behavior does seem to be slower in coming than we had anticipated, and a tightening of credit policies, like those that usually reinforced Fed tightenings in the past, is not in evidence yet. Our expectation, however, is that institutions will start to become a bit more cautious in their lending, as they reexamine swollen loan portfolios against a backdrop of a less robust economic environment -and as they perhaps experience a few more delinquencies.

Near-term Forecast

Data received since the BEA prepared its advance report point to little change in the first-quarter estimate of real GDP growth. However, the rate of increase in domestic final sales appears likely to be revised up somewhat, while inventory change probably will be revised down moderately. The only key first-quarter report still outstanding -the March report on merchandise trade--will be released tomorrow.

This quarter, real GDP growth is projected to slow to roughly 1 percent at an annual rate. Inventory accumulation, which, on our estimate, accounted for more than a half percentage point of the first-quarter rise in aggregate output, likely will be a sizable negative in the second quarter. Growth of final sales is projected to be a little above 2-1/4 percent, the same as what available data indicate for the first quarter; in the second half of 1994, final sales had increased at an annual rate of about 5 percent, on average.

SUMMARY OF THE NEAR-TERM OUTLOOK
(Percent change, at annual rates, unless otherwise noted)

	1995:Q1[1]	1995:Q2
Real GDP	2.8	.9
Previous	2.5	1.7
Final sales	1.8	2.1
Previous	1.9	3.7
Unemployment rate[2]	5.5	5.7
Previous	5.5	5.5
Industrial production	4.6	-3.0
Previous	6.7	1.2

1. Figures shown for real GDP and final sales are from the BEA's advance report for the first quarter.
2. Quarterly average, percent.

Evidence of a further slowdown in activity has been showing up fairly consistently in recent weeks in indicators of production and sales. Although the data from the labor market surveys for April contained a larger than usual amount of "noise," owing to problems of seasonal adjustment and some other special factors, we interpret the data as pointing to a slowing in the growth of labor demand from the pace earlier this year. A rise in initial claims for unemployment benefits in late April and early May reinforces this impression. Importantly, the figures on manufacturing payrolls square with other information on the industrial sector, which suggests rather strongly that factory output will be down appreciably this quarter.

Much of the second quarter slowdown in real GDP growth is expected to result from a decline in production of motor vehicles. In the last Greenbook, we had anticipated that automakers would be cutting assemblies this quarter to work off a moderate first-quarter backup of stocks and to adjust to lowered expectations of sales for 1995 as a whole. But, because of industry responses to the stunning dive in sales in April, motor vehicle production looks now to be subtracting 1-1/2 percentage points from the second-quarter GDP growth rate. We expect that most of the decline in output will show through as a sharp negative swing in inventory accumulation. Sales are projected to move back up somewhat in May and June. Nonetheless, the industry is not expected to get back to a desired balance between production and sales until some time in the third quarter.

Residential investment is also likely to be a sizable negative in the second quarter, as the sharp decline in housing starts since the start of the year translates, with a lag, into diminished expenditures for construction. With builders and homebuyers recently expressing some increased optimism about the housing market, we think that starts will begin to tilt back up in coming months; nonetheless, the average level of starts this quarter probably will still be down a little from that of the first.

We are projecting only a moderate gain in consumer spending this quarter. Although disbursement of delayed tax refunds and gains in wealth from higher securities prices are pluses, the data on retail sales for April provided a weak start for the quarter.

First-quarter growth in real BFI exceeded our forecast by a sizable amount, partly because of an unexpected spike in aircraft deliveries.[1] Although aircraft outlays likely will drop back in the second quarter, orders for other capital goods have been strong in the past couple of months and we are projecting that second-quarter PDE growth will come in at a still robust 10 1/2 percent at an annual rate. Indicators of construction spending have been strong as well, with big gains in March in both construction put-in-place and new building permits.

We have made only minor changes to our second-quarter forecast of government purchases, as few second-quarter indicators currently are available. Federal purchases are expected to continue declining this quarter, though less rapidly than in the first, and we think state and local purchases, which were essentially flat in the first quarter, will post a moderate advance this period.

Real exports of goods and services were virtually flat in the BEA advance estimate for the first quarter. Although merchandise trade figures for March will not be available until tomorrow, it is fairly clear that the first-quarter contraction in shipments to Mexico put a sizable dent in what had been a strong uptrend in

1. Also, some of the data that had led us to predict a first-quarter slowdown in spending were revised up sharply just after the March Greenbook was completed.

exports through the end of last year. As noted earlier, this drag should be abating, allowing the underlying uptrend in exports to begin to reassert itself this quarter. Reflecting in part the adjustment of inventories, import growth is expected to remain at around the first-quarter pace, which was much more moderate than the rates of growth in either 1993 or 1994.

The CPI excluding food and energy is projected to rise at an annual rate of about 3-1/2 percent this quarter; the increases projected for May and June (a quarter percent per month) are slightly smaller than that in April. Efforts to clear out excess stocks of autos and other consumer goods should restrain price increases to some degree, and auto finance charges should decelerate. At the same time, however, the ongoing pass-through of materials cost increases will maintain pressure on the prices of finished goods. The total CPI also is forecast to rise at a rate of about 3-1/2 percent, as both food and energy prices accelerate from relatively low first-quarter rates of increase.

<u>The Longer-Run Outlook for the Economy</u>

The course of the economy through the summer will depend to an important degree on the shape of the inventory correction that now appears to be unfolding. On that count, we believe that businesses are moving quickly to clear away overhangs that have developed this year, but we don't think that the process will be completed by mid-year. Thus, a downshift in stockbuilding is expected to subtract considerably from output growth in the third quarter as well. Thereafter, inventory investment is essentially a neutral factor in the GDP forecast.

Growth of domestic final demand obviously has slackened considerably already, and only moderate advances are anticipated, on average, in coming quarters. Consumer spending seems unlikely to regain its former vigor now that pent-up demands for vehicles and other durables have been largely satisfied and income growth is slowing. In addition, business fixed investment is not likely to maintain the frenetic growth pace of the past several quarters. However, lower mortgage rates should restore an upward tilt to residential construction. In the external sector, an improving export trend and a softening of demand for imports is likely to produce solid gains in real net exports over the next year and a half.

SUMMARY OF STAFF GDP PROJECTIONS
(Percent change, at annual rates)

	1995			
	Q2	Q3	Q4	1996
Real GDP	.9	1.9	2.8	2.4
Previous	1.7	2.1	2.3	2.3
Final sales	2.1	3.4	2.4	2.5
Previous	3.7	2.8	2.4	2.3
Real PCE	2.3	3.0	2.1	2.1
Previous	3.7	2.1	2.1	2.0
Real BFI	10.4	9.7	6.1	5.3
Previous	14.3	8.0	6.1	4.9
Real residential investment	-17.9	-.6	3.8	2.8
Previous	-9.0	.1	.4	1.1

Real GDP growth averages about 2-1/4 percent over the 1995-96 period, reversing at least some of the overshooting of full employment that occurred during 1994. Still, the projection anticipates that a modest degree of inflationary pressure remains through the end of next year. To restore a downward trend to inflation, resource utilization rates would likely have to be lowered somewhat further. Partly with that in mind, we later provide a model simulation of a tighter monetary policy that might produce the additional slack; we also present the symmetric case of an easier policy.

Personal consumption expenditures. We have been expecting for some time that the growth of real personal consumption expenditures would slow appreciably in 1995, but the slowdown has been sharper than expected.

The surprise has been largely concentrated in auto sales, and an assessment of the recent weakness in that sector is obviously important in gauging whether consumer demand is likely to firm in coming months. Unfortunately, while we have been consistently less optimistic than the automakers about industry sales prospects, we share their puzzlement at the sharp drop last month. Such fundamentals as income growth, interest rates, and relative prices would not seem to justify a contraction of demand of that magnitude--especially so suddenly. We don't think it would be wise to ignore this development entirely, however, and thus we have viewed it as a signal that the underlying trend of demand is weaker than we had been assuming. Thus, while we expect a rebound from the low April pace, we have reduced our prediction of total light vehicle sales in both 1995 and 1996 by just over a quarter-million units, to an average of 14.7 million; this figure compares with sales last year of nearly 15.1 million units.

Consumer outlays for durable goods other than vehicles are projected to rise at a rate of about 3 percent in the second half of 1995, and an increase of 2-1/4 percent is predicted for 1996. Purchases of non-vehicle durables increased more than 30 percent over the three years ended in 1994, and we think that households will not keep pushing spending up at a rapid pace from levels that already seem quite high. With increases in real outlays for nondurables and services also expected to proceed at moderate rates in coming quarters, total PCE is predicted to rise 2-1/4 percent over the four quarters of 1995 and 2 percent in 1996.

After reversing some of its first-quarter bulge over the near term, the personal saving rate changes little over the remainder of the forecast horizon, holding in a range that is moderately above the average for 1993 and for 1994. Basically, we think that factors that might tend to exert downward pressure on the saving rate will be roughly in balance with factors that might be working to push it higher. Among the former is the large rise in stock market wealth since the start of the year; a likely pickup in mortgage refinancings would also be a plus, although much of the refinancing activity would involve the exchange of recent adjustable-rate loans for fixed-rate loans, with no payment reduction and little cashing out of equity. On the other side, the more moderate pace of employment growth may make households a little more cautious about spending, especially in light of the run-up in indebtedness that has occurred over the past couple of years.

Residential investment. We expect to see moderate increases in housing starts in the second half of this year and in the early part of 1996. Impetus for this anticipated rise comes primarily from the drop in mortgage interest rates that has occurred since late last year. This drop in rates has made single-family houses more affordable and prompted a considerable improvement in perceived homebuying conditions. It will take a few months of increased demand to bring the stock of unsold units back to comfortable levels, but we expect that by the fourth quarter single-family starts will be up about 8 percent from the depressed pace of March and April. Multifamily starts also should resume a mild upward trend in coming months, although we continue to believe that the overhang of vacant units in many locales will put a low ceiling on aggregate apartment construction.

Our housing forecast for the next couple of years continues to be shaped in part by our perceptions of how economic conditions will be interacting with some important demographic trends. Most notably, we think that economic circumstances are favorable enough to allow young adults to start forming separate households at a faster pace; thus far in the 1990s, household formation has been surprisingly low. In addition, our projection that single family starts will continue to make up a high share of the total reflects an expectation that good cash-flow affordability and the increased availability of low downpayment loans will result in an inching up of the homeownership rate, which is still below the peak reached around 1980.

Business fixed investment. Some of the puzzles that we perceived in the indicators of investment spending in the last Greenbook cycle have since been solved. In particular, data that seemed to be pointing to a slump in computer investment were revised up shortly after the March Greenbook was completed, and subsequent data on orders and shipments of office and computing equipment have been quite strong. Strength also has continued to be evident in orders and shipments of most other types of capital goods, and most indicators of nonresidential construction also have been fairly robust. On the basis of these indicators, we now think that business fixed investment will remain quite brisk through the third quarter of 1995.

Later this year, however, and in 1996, effects of the economic slowdown should begin to damp business investment more perceptibly. The need to add to capacity will seem less urgent as the economic expansion slows, and reduced rates of growth of profits and business cash flow also will begin to instill an element of greater caution in business investment decisions. We are projecting that the growth of total BFI will slow to a rate of about 6 percent in the fourth quarter of this year and that next year's gain will be around 5 percent. Growth of real investment in office and computing equipment is projected to slow to a pace of 12-1/2 percent in 1996, compared with an average rate of more than 30 percent over the first four years of the expansion. Real investment in other types of equipment is expected to increase only a little over the course of next year. Even so, the level of spending would remain high, so that the stock of capital equipment would continue to expand at a relatively brisk pace, consistent with the view that rapidly changing technology and competitive pressures to increase efficiency will continue to induce companies to invest heavily.

Investment in nonresidential structures is expected to rise 10 percent over the four quarters of 1995 and 5 percent in 1996. On the whole, indicators of underlying market conditions in this sector of the economy have continued to improve, and as nonresidential construction usually has lagged behind other sectors of the economy over the course of the business cycle, we anticipate that some of its current strength will carry over into next year. By the end of 1996, the level of investment in nonresidential structures is expected to have reversed fully the sharp declines that took place earlier in the 1990s. (However, the projected level of investment at the end of 1996 still is considerably below the peaks of the mid-1980s.)

Inventory investment. Over the past four quarters, nonfarm inventories have increased more than 5 percent. At least until recently, the pace of final sales required a rapid accumulation of stocks to maintain a normal buffer, let alone to provide an extra hedge against materials price increases and other supply problems that might be encountered in an environment of higher capacity utilization, lengthening order times, and less reliable delivery performance. With demand trends now perceived to be moderating and pressures on capacity easing in many sectors, we believe that businesses will be seeking to trim inventory accumulation sharply.

Real nonfarm business inventories are expected to grow at a rate of about 4 percent in the current quarter and at an average rate of about 2 percent thereafter.[2] Arithmetically, the slowing of nonfarm stockbuilding subtracts about 1 percentage point from real GDP growth in the second quarter and close to 1-1/2 percentage points in the third, but part of the inventory adjustment likely will be accomplished through a damping of import growth rather than through cuts in domestic production. From the third quarter forward, quarterly changes in the rate of accumulation are small and generally have little influence on the growth of real GDP.

Government purchases. On our baseline assumption about fiscal policy, federal purchases of goods and services are expected to continue trending lower from mid-1995 through the end of 1996, but with some shifts in the mix. Reductions in defense expenditures will occur at a slower rate than in 1993 or 1994, while nondefense purchases, which showed only small declines in the past two years, are expected to start falling more rapidly. All told, we think that federal purchases will fall about 4-1/2 percent in both 1995 and 1996. For both the defense and nondefense categories, the predicted declines this year and next are quite similar to those contained in

2. The incoming inventory data of recent weeks suggest that the BEA's advance estimate of inventory accumulation in the first quarter was about $6 billion too high (annual rate). Following "best change" methodology, we have carried that higher level of accumulation through subsequent quarters. As a result, the level of inventory change in the forecast is $6 billion above the trajectory that we would be writing down if the revised first-quarter data actually were in hand.

the last Greenbook. On a unified basis, the federal deficit in fiscal 1995 has been nudged down to $166 billion; the forecast of the deficit for fiscal 1996 has been raised about $10 billion, to $190 billion, mainly because of technical factors.

State and local purchases of goods and services are expected to remain on a modest uptrend, rising about 1-1/2 percent in real terms this year and 2 1/4 percent next year. Considerable variation currently is evident in the financial fortunes of governmental units, but even in those jurisdictions where revenue growth has been especially good, pressures for tax relief are preventing spending from moving up the way it often has in the past. Indeed, the constraints on spending might be even greater were it not for the fact that legislators in a number of states have been unwilling to approve tax cuts as big as their governors had proposed.

Meanwhile, states and localities are facing major uncertainties regarding the future of federal grants, as well as uncertainties related to potential shifts in the balance of responsibilities within the federal system. Without hazarding a guess as to how those uncertainties will be resolved, we think that slow to moderate growth of state and local purchases is the most likely possibility in coming quarters, although the risks in this part of the forecast may be somewhat greater than usual.

Net exports. After increasing about 11-1/2 percent in 1994, real exports of goods and services are expected to increase about 5 percent in 1995 and 9 percent in 1996. The smaller increase this year is mainly a reflection of the slowing in foreign economic growth, exaggerated in the very near term by the sharp current account adjustment in Mexico; with the latter influence waning, the strong competitive position of the United States shows through more fully again in 1996. Real imports of goods and services, after rising at rates of around 13 percent, on average, in 1993 and 1994, are projected to increase at rates of roughly 5 percent to 6 percent this year and next. The slowdown from past rates mirrors the deceleration in growth in the U.S. economy and the effects of dollar depreciation on the prices of imports. (More detail on exports and imports is contained in the International Finance section of the Greenbook.)

Labor markets. Businesses seem to be moving fairly quickly to adjust employment as the growth of output slows. We are anticipating a moderate bounceback in hiring in May, as some of the special factors that affected the April numbers are reversed. Thereafter, job growth is projected to proceed at a rate of about 135,000 a month through the third quarter, compared with average gains in the first quarter of about 235,000 a month. Fourth-quarter gains in employment are projected to be slightly less than those of the third quarter.

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

	1994	1995	1996
Output per hour, nonfarm business	2.0	.8	1.5
Previous	1.4	.8	1.4
Nonfarm payroll employment	3.1	1.7	1.3
Previous	3.1	1.8	1.1
Civilian unemployment rate[1]	5.6	5.8	5.8
Previous	5.6	5.7	5.8

1. Average for the fourth quarter.

By adjusting labor input fairly quickly as growth of output slows, businesses are expected to achieve another year of productivity gain in 1995. We are forecasting, in particular, that output per hour in the nonfarm business sector will rise 0.8 percent over the four quarters of 1995. Some near-term slippage is followed by renewed gains in the second half of the year.

The forecast for 1996 has output and labor input moving ahead at rates that are roughly in line with those that might be expected in the "steady state." Output rises at a pace about in step with potential, and productivity increases at a rate that matches our estimate of the trend rate of productivity growth. Under these circumstances, job growth over the four quarters of 1996 is expected to be about 1-1/2 million, compared with increases of 3-1/2 million in 1994 and 2 million in 1995.

Our forecast of labor market conditions also is dependent on our assumptions about labor force participation. After rising only slightly over the first few years of the current expansion, the participation rate began tilting up a bit more noticeably late last year, and it has increased somewhat further over the first four months of 1995. But with economic growth moderating this year, the rise in participation is expected to slow again. We are predicting cumulative net gains in the participation rate of about 1/2 percentage point over the four quarters of 1995 and 1/4 percentage point in 1996. Growth in the number of job-seekers of the magnitude we anticipate holds the unemployment rate steady, given our forecasts of output and labor demand.

Wages and prices. The surprisingly small first-quarter increase in the employment cost index has caused us to revise down our forecast of compensation. The increase in the index for benefits was minute and provided dramatic evidence of the success firms are having in gaining control of non-wage labor costs, especially those related to medical care. Although we do not expect increases in benefits in coming quarters to be nearly so small as that in the first quarter, the trend probably is lower currently than we previously had forecast. We now are predicting that the ECI for benefits will rise only 2-1/2 percent this year, more than a percentage point less than the increase of 1994. Only a moderate pickup in the rate of increase is predicted for 1996, to 3-1/4 percent. Much faster rates of increase--in the range of 5 percent to 6-1/2 percent--had prevailed over several years leading up to 1994.

The marked slowing of the rise in benefit costs of the past year or so has not been accompanied by an offsetting acceleration of wages. The rise in the ECI for wages and salaries over the year ended in March--2.9 percent--was close to the increases reported in each of the two preceding years. Moreover, recent anecdotal reports do not seem to be pointing to any significant pickup in wages, although there continue to be a few scattered references to shortages of qualified workers. Our forecast of the ECI for wages and salaries continues to show a relatively mild uptilt in coming quarters, with the year-to-year rate of change moving up to 3.4 percent by the end of 1996.

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

	1994	1995	1996
Consumer price index	2.6	3.1	3.0
Previous	2.6	3.1	3.0
Excluding food and energy	2.8	3.3	3.1
Previous	2.8	3.2	3.2
ECI for compensation of private industry workers[1]	3.1	3.1	3.4
Previous	3.1	3.4	3.7

1. December to December.

Our forecast of core inflation from mid-1995 forward has been revised down in this Greenbook, but the size of the revision is not as large as the downshift in our forecast of hourly compensation.

For 1995, slightly lower rates of inflation in the second half of the year about offset the slightly larger-than-expected step-up of the first half; the gain over the four quarters of the year--3.3 percent--is just a hair more than was projected in the March Greenbook. For 1996, the forecast of core inflation has been revised down 0.1 percentage point to 3.1 percent. The rise in this index in 1994 was 2.8 percent.

In making only a small downward revision to the price forecast for the period ahead while making a more sizable cut in the forecast of hourly compensation, we have been swayed in part by the comparative performance of alternative models that we use in price forecasting. Specifically, models that relate changes in price inflation directly to the degree of slack have been performing relatively well while similar models for wages have been tending to overpredict the rate of wage change for some time. One possible explanation for this divergence might simply be that the data are wrong. Another possible explanation, though, is that structural changes in the economy may have heightened workers' concerns about job security and restrained real wage demands--indeed, anecdotal reports supporting this explanation have been numerous. How long such circumstances might persist is not clear. But, in view of the uncertainties, we have taken the pragmatic approach of leaning in the direction of forecasting models with the best track record.

The slight "bump" in the forecast of core inflation in 1995 reflects near-term pressures from import prices and materials prices. Core inflation slows in 1996, when these two influences are expected to be less strong than in 1995. Abstracting from the two influences, the forecast of core inflation shows a pattern of very gradual acceleration from 1994 to 1996, consistent with the modest excess of aggregate demand over potential supply.

The total CPI is expected to increase 3.1 percent in 1995, up from 2.6 percent in 1994. A rise of 3.0 percent is predicted for 1996. Energy prices rise somewhat faster than core inflation in the forecast for this year, but the rate of rise drops back next year to well below that of the core CPI. By contrast, food prices decelerate this year, to a pace about a percentage point below that of core inflation, but then pick up a little in 1996.[3] With regard to the food price outlook, we still are assuming that crop yields will be "normal" this year, despite some recent delays in the planting of grains. At this juncture, our feeling is that the potential size of the 1995 harvest has not been greatly impaired by the planting delays, but the situation could become more serious if the rains do not let up.[4]

Alternative Simulations

Using the Board staff's econometric models, we've run two simulations that employ alternative assumptions about the fed funds rate. We also have run a simulation of the economy with an assumption of faster deficit reduction than is assumed in the baseline forecast.

In the first of the fed funds alternatives, the funds rate is raised 50 basis points in the third quarter of 1995 and another 50 basis points in the fourth. It then remains unchanged through 1996. The second fed funds simulation is symmetric to the first and

3. The BLS indicated a few months ago that changes in methodology that it instituted at the start of 1995 were likely to take 0.4 percentage point off the rate of rise in the CPI for food at home, which accounts for about two-thirds of total food in the CPI.

4. Historically, delays in planting have occurred fairly often in early stages of the annual crop cycles. Usually, a favorable turn in the weather has created a window of opportunity for farmers to catch up before serious damage is incurred; the one big exception to the usual pattern was the experience of 1993, when heavy rains persisted past mid-year and kept millions of acres from being planted.

has the funds rate moving down 100 basis points in the second half of this year and showing no further change thereafter.

ALTERNATIVE FEDERAL FUNDS RATE ASSUMPTIONS
(Percent change, Q4 to Q4, unless otherwise noted)

	1994	1995	1996
Real GDP			
Baseline	4.1	2.1	2.4
Higher funds rate	...	2.0	1.8
Lower funds rate	...	2.2	3.0
Civilian unemployment rate[1]			
Baseline	5.6	5.8	5.8
Higher funds rate	...	5.8	6.0
Lower funds rate	...	5.8	5.5
CPI excluding food and energy			
Baseline	2.8	3.3	3.1
Higher funds rate	...	3.3	2.9
Lower funds rate	...	3.3	3.3

1. Average for the fourth quarter.

As shown in the table, the alternative simulation with the higher funds rate keeps growth of real GDP in a range of 2 percent or less this year and next. The civilian unemployment rate rises a little above the baseline projection, and this--together with dollar appreciation associated with the risk in interest rates--pushes the core rate of inflation down. By contrast, the alternative with the lower funds rate takes the civilian unemployment rate back down to 5-1/2 percent by the end of 1996. At that unemployment rate, pressures from the tightening of labor and product markets fully offset the effects of a slower rise in import prices; the core CPI moves up in 1996 by the same amount as in 1995, with the underlying trend headed up more significantly as the economy moves into 1997.

The simulation that is based on an alternative assumption about fiscal policy allows for $50 billion in deficit reduction in fiscal 1996, rather than the $20 billion in the baseline forecast. The amount of near-term deficit reduction under this alternative is comparable in magnitude to reductions that are outlined in the House and Senate budget committee proposals. We have assumed that the incremental reduction comes entirely on the spending side, with cuts in nondefense purchases, transfers, and federal grants to states and localities.[5] As in our baseline forecast, the fed funds rate remains unchanged through the end of 1996. In addition, we have not allowed for anticipatory effects in the stock and bond markets--but given the short time period involved, the GDP consequences of such responses would not obviously be large in any event.

The simulated economic outcome under this alternative fiscal scenario is depicted in the table below. The additional fiscal restraint holds GDP growth to around 2 percent through 1996, and the unemployment rate moves up to 6 percent. Inflation rates are little affected, in part because states are expected to make up for some of the loss of federal revenue by raising indirect business taxes, adding to the prices paid by consumers.

ALTERNATIVE FISCAL ASSUMPTION
(Percent change, Q4 to Q4, unless otherwise noted)

	1994	1995	1996
Real GDP			
Baseline	4.1	2.1	2.4
Larger deficit reduction	...	2.0	1.9
Civilian unemployment rate[1]			
Baseline	5.6	5.8	5.8
Larger deficit reduction	...	5.8	6.0
CPI excluding food and energy			
Baseline	2.8	3.3	3.1
Larger deficit reduction	...	3.3	3.2

1. Average for the fourth quarter.

5. The baseline package includes a tax credit for children, plus various spending cuts.

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

May 17, 1995

Interval	Nominal GDP 3/22/95	Nominal GDP 5/17/95	Real GDP 3/22/95	Real GDP 5/17/95	GDP fixed-weight price index 3/22/95	GDP fixed-weight price index 5/17/95	Consumer price index[1] 3/22/95	Consumer price index[1] 5/17/95	Unemployment rate (level except as noted) 3/22/95	Unemployment rate (level except as noted) 5/17/95
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[2]	6.2	6.2	4.0	4.1	2.7	2.7	2.6	2.6	6.1	6.1
1995	5.4	5.2	2.9	3.0	3.0	3.0	3.1	3.1	5.6	5.7
1996	4.7	4.8	2.3	2.3	2.9	2.9	3.0	3.0	5.7	5.8
QUARTERLY										
1993 Q1[2]	4.4	4.4	1.2	1.2	4.2	4.2	3.1	3.1	7.0	7.0
Q2[2]	4.2	4.2	2.4	2.4	2.4	2.4	2.8	2.8	7.0	7.0
Q3[2]	3.8	3.8	2.7	2.7	2.0	2.0	1.7	1.7	6.7	6.7
Q4[2]	7.7	7.7	6.3	6.3	2.4	2.4	3.4	3.4	6.5	6.5
1994 Q1[2]	6.1	6.1	3.3	3.3	3.1	3.1	2.2	2.2	6.6	6.6
Q2[2]	7.2	7.2	4.1	4.1	2.9	2.9	2.5	2.5	6.2	6.2
Q3[2]	6.2	6.2	4.0	4.0	3.0	3.0	3.6	3.6	6.0	6.0
Q4[2]	5.8	6.4	4.6	5.1	2.6	2.6	2.2	2.2	5.6	5.6
1995 Q1[2]	5.8	5.1	2.5	2.8	3.5	3.1	3.2	3.2	5.5	5.5
Q2	4.1	3.5	1.7	.9	2.7	2.9	3.1	3.6	5.5	5.7
Q3	4.4	4.5	2.1	1.9	2.7	3.0	3.1	3.2	5.6	5.7
Q4	4.6	5.3	2.3	2.8	2.7	2.9	3.0	2.8	5.7	5.8
1996 Q1	4.9	4.8	2.3	2.1	3.1	3.2	3.0	2.9	5.7	5.8
Q2	4.8	4.8	2.4	2.4	2.8	2.8	3.0	3.0	5.7	5.8
Q3	4.8	4.9	2.3	2.5	2.8	2.8	3.0	3.0	5.7	5.8
Q4	4.7	4.8	2.2	2.4	2.9	2.8	3.0	3.0	5.8	5.8
TWO-QUARTER[3]										
1993 Q2[2]	4.3	4.3	1.8	1.8	3.3	3.3	3.0	3.0	-.3	-.3
Q4[2]	5.7	5.7	4.5	4.5	2.2	2.2	2.5	2.5	-.5	-.5
1994 Q2[2]	6.6	6.6	3.7	3.7	3.0	3.0	2.3	2.3	-.3	-.3
Q4[2]	6.0	6.3	4.3	4.6	2.8	2.8	2.9	2.9	-.6	-.6
1995 Q2	4.9	4.3	2.1	1.8	3.1	3.0	3.1	3.3	-.1	.1
Q4	4.5	4.9	2.2	2.3	2.7	2.9	3.0	3.0	.2	.1
1996 Q2	4.9	4.8	2.4	2.3	3.0	3.0	3.0	2.9	.0	.0
Q4	4.7	4.8	2.2	2.5	2.9	2.8	3.0	3.0	.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[2]	6.3	6.5	4.0	4.1	2.9	2.9	2.6	2.6	-.9	-.9
1995 Q4	4.7	4.6	2.1	2.1	2.9	3.0	3.1	3.1	.1	.2
1996 Q4	4.8	4.8	2.3	2.4	2.9	2.9	3.0	3.0	.1	.0

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)

May 17, 1995

Item	Unit[1]	1988	1989	1990	1991	1992	1993	1994	Projected 1995	Projected 1996
EXPENDITURES										
Nominal GDP	Bill $	4900 4	5250 8	5546 1	5724 8	6020 2	6343 3	6738 4	7090.0	7429 7
Real GDP	Bill 87$	4718 6	4838 0	4897 3	4867 6	4979 3	5134 5	5344 0	5503 1	5627 3
Real GDP	% change	3 3	1 6	2	3	3 7	3 1	4 1	2.1	2 4
Gross domestic purchases		2 5	9	- 4	- 1	4 1	3 9	4 5	2.2	2 1
Final sales		4 2	1 5	1 2	- 4	3 8	3 0	3.4	2.4	2 5
Private dom final purch		4 2	5	- 1	- 8	5 1	5 0	4 9	3.2	2 7
Personal cons expend		4 2	1 2	7	0	4 2	3 0	3.5	2.2	2 1
Durables		8 5	- 5	- 8	-1 3	9 6	9 0	8 6	9	2 2
Nondurables		3 2	1 2	- 1	-1 6	3 2	1 3	3 1	1 9	1 8
Services		3 7	1 7	1 7	1 2	3 5	2 5	2.4	2 7	2 3
Business fixed invest		5 5	- 4	7	6 2	6 7	16.0	12 9	11 3	5 3
Producers' dur equip		9 1	1 7	2 9	-3 2	11 0	21 3	15 5	11 7	5 3
Nonres structures		-1 2	2 3	-3 9	-12 4	-3 4	1 6	4.6	9 7	5 3
Res structures		9	-7 7	-15 2	7	17 0	8 1	3 1	-5 7	2 8
Exports		13 5	11 3	6 7	8.1	5 0	5 8	11 6	5 3	9 3
Imports		3 6	2 6	4	4 0	8 6	12 4	13 8	5 9	6 5
Government purchases		2	2 0	3.3	- 8	7	-1 0	-1 0	- 5	1
Federal		-3 4	- 6	2.8	-3.2	8	-6 9	-5 9	-4 3	-4 4
Defense		-3 2	1 5	1 5	-7 0	-1 3	-9 0	-8 2	-4 4	-4 5
State and local		2 9	4 0	3.6	8	6	3 0	2 0	1 6	2 2
Change in bus invent	Bill 87$	19 9	29 8	5.7	-1 1	2 5	15 3	47 8	42.3	26 2
Nonfarm		26 9	29 9	3.2	-1 3	-2 0	18 5	40 7	39.4	24 7
Net exports		-104 0	-73 7	-54 7	-19 5	-32 3	-73 9	-110 0	-119.9	-110 2
Nominal GDP	% change	7 7	6 0	4 7	3 5	6 4	5 0	6 5	4 6	4 8
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employ	Millions	105.2	107 9	109 4	108 3	108 6	110 5	113 4	116 2	117 7
Unemployment rate	%	5 5	5 3	5 5	6 7	7 4	6 8	6 1	5 7	5 8
Industrial prod index	% change	3 2	- 1	- 2	2	4 0	3 6	6 0	1 6	3 0
Capacity util rate-mfg	%	83 6	83 2	81 3	78.0	79.2	80.9	83 4	83 2	81 7
Housing starts	Millions	1.49	1 38	1 19	1 01	1 20	1 29	1.46	1 31	1 40
Light Motor Vehicle Sales		15.43	14 53	13.85	12 31	12 80	13 89	15.07	14 58	14 81
Auto sales in U.S.		10.63	9 91	9 50	8 39	8 35	8 72	9 24	8 70	8 86
North American prod.		7 54	7 08	6 90	6 14	6 26	6 75	7 28	7.01	7 13
Other		3.10	2 83	2 60	2 25	2 10	1 97	1 96	1.69	1 73
INCOME AND SAVING										
Nominal GNP	Bill $	4908 2	5266 8	5567.8	5740 8	6025 8	6347 8	6726.9	7060 0	7387 1
Nominal GNP	% change	7 8	6 1	4 9	3 2	6 1	5.0	6 1	4 4	4 7
Nominal personal income		7 1	6 5	6 5	3 7	8 1	2 8	6 8	5 5	4 7
Real disposable income		3 2	1 1	1 1	9	5.0	5	4 4	2 4	1 9
Personal saving rate	%	4.4	4 0	4 2	5.0	5 5	4 1	4 1	4 8	4 6
Corp. profits, IVA&CCAdj	% change	10 2	-6 3	2 3	8.8	9 6	23.4	4 9	2 6	2 1
Profit share of GNP	%	7.4	6 9	6 8	6 8	6.7	7 7	8 1	8 0	7 9
Federal surpl./def	Bill $	-136 6	-122 3	-163 5	-202.9	-282 7	241 4	-159.1	-149 2	-146 1
State/local surpl /def		38 4	44 8	25 1	17 0	24.8	26 3	26 2	29 3	33.0
Ex social ins. funds		-18 4	-17 5	-35 6	-46 5	-41 6	-40 0	-39.3	-35.4	31 1
PRICES AND COSTS										
GDP implicit deflator	% change	4 2	4.4	4 5	3 3	2 6	1 8	2.3	2.5	2 4
GDP fixed-wt price index		4 2	4 4	4.6	3 6	3 2	2 8	2.9	3 0	2 9
Gross domestic purchases fixed-wt price index		4 1	4.4	5 2	2 9	3 2	2 5	2 9	3 0	2 9
CPI		4 3	4 6	6 3	3 0	3 1	2 7	2 6	3 1	3 0
Ex food and energy		4 5	4 4	5 3	4 4	3 5	3 1	2 8	3 3	3 1
ECI, hourly compensation[2]		4 8	4 8	4 6	4 4	3 5	3 6	3 1	3 1	3 4
Nonfarm business sector										
Output per hour		5	-1 4	4	2 3	3 2	1 8	2.0	8	1 5
Compensation per hour		3 8	3 1	6 2	4 7	5 1	2 4	3 3	3 3	3 5
Unit labor cost		3 3	4 6	5 7	2 3	1 9	6	1 3	2.6	1 9

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

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

May 17, 1995

Item	Unit	1992 Q1	1992 Q2	1992 Q3	1992 Q4	1993 Q1	1993 Q2	1993 Q3	1993 Q4	1994 Q1	1994 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	5.6	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	1.18	1.23	1.16	1.25	1.31	1.47	1.36	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		2.9	2.9	3.2	3.5	3.1	2.8	1.7	3.4	2.2	2.5
Ex. food and energy		3.7	3.3	3.3	3.6	3.5	3.5	2.4	2.9	2.9	2.9
ECI, hourly compensation[2]		4.0	2.9	2.8	3.9	4.2	3.5	3.4	3.4	3.0	3.4
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)

May 17, 1995

Item	Units	1994 Q3	1994 Q4	Projected 1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4
EXPENDITURES											
Nominal GDP	Bill. $	6791.7	6897.2	6982.9	7043.3	7120.8	7213.1	7298.3	7385.0	7474.0	7561.5
Real GDP	Bill. 87$	5367.0	5433.8	5471.7	5483.8	5509.1	5547.7	5576.6	5609.9	5644.4	5678.2
Real GDP	% change	4.0	5.1	2.8	.9	1.9	2.8	2.1	2.4	2.5	2.4
Gross domestic purchases		4.4	4.2	3.7	1.1	1.7	2.5	1.8	2.2	2.3	2.0
Final sales		4.3	5.7	1.8	2.1	3.4	2.4	2.4	2.6	2.5	2.6
Private dom. final purch		4.1	6.8	3.6	2.5	3.9	2.8	2.8	2.8	2.7	2.5
Personal cons. expend		3.1	5.1	1.4	2.3	3.0	2.1	2.1	2.2	2.2	2.1
Durables		5.8	20.4	4.7	.2	6.3	2.0	1.3	2.4	2.7	2.5
Nondurables		3.3	3.1	1.5	2.0	2.6	1.5	1.8	1.8	1.8	1.8
Services		2.2	2.3	3.1	3.0	2.3	2.4	2.4	2.3	2.3	2.1
Business fixed invest		14.1	17.6	19.3	10.4	9.7	6.1	5.5	5.5	5.3	5.1
Producers' dur. equip		18.1	19.6	20.8	10.6	10.2	5.8	5.2	5.3	5.4	5.5
Nonres. structures		1.6	11.0	14.1	9.9	7.8	7.1	6.6	6.1	4.9	3.9
Res. structures		-6.0	2.3	-6.6	-17.9	-.6	3.8	4.9	4.1	1.5	.6
Exports		14.8	20.2	.6	6.6	7.0	8.5	8.8	9.5	9.3	9.5
Imports		15.6	11.4	5.9	6.9	4.9	5.7	6.0	7.1	7.0	5.9
Government purchases		6.7	-4.1	-1.6	.9	-.2	-1.2	-1.1	.1	.4	.3
Federal		10.9	-14.4	-4.6	-1.7	-4.8	-6.0	-7.0	-3.9	-3.2	-3.4
Defense		12.8	-21.8	-7.1	-.7	-6.7	-3.0	-4.7	-5.3	-4.2	3.7
State and local		4.3	2.3	.2	2.3	2.4	1.5	2.1	2.3	2.3	2.2
Change in bus. invent	Bill. 87$	57.1	49.4	63.0	47.5	26.5	32.3	28.5	26.5	25.8	23.8
Nonfarm		47.4	41.7	58.3	44.0	24.5	30.8	27.0	25.0	24.3	22.3
Net exports		-117.0	-107.1	-119.7	-122.4	-120.3	-117.2	-114.2	-112.1	-109.7	-104.6
Nominal GDP	% change	6.2	6.4	5.1	3.5	4.5	5.3	4.8	4.8	4.9	4.8
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employ	Millions	113.9	114.8	115.6	116.0	116.4	116.8	117.1	117.5	117.9	118.3
Unemployment rate[1]	%	6.0	5.6	5.5	5.7	5.7	5.8	5.8	5.8	5.8	5.8
Industrial prod. index	% change	4.9	5.9	4.6	-3.0	1.5	3.3	2.9	2.9	3.0	3.1
Capacity util. rate-mfg[1]	%	83.6	84.5	84.7	83.1	82.5	82.4	82.1	81.8	81.5	81.3
Housing starts	Millions	1.47	1.51	1.31	1.27	1.31	1.36	1.39	1.39	1.40	1.40
Light Motor Vehicle Sales		14.65	15.44	14.90	14.18	14.68	14.55	14.65	14.76	14.86	14.96
Auto sales in U.S.		9.09	9.25	8.84	8.44	8.80	8.73	8.78	8.85	8.89	8.93
North American prod.		7.09	7.42	7.03	6.83	7.20	7.00	7.08	7.12	7.14	7.18
Other		2.01	1.83	1.81	1.61	1.60	1.73	1.70	1.73	1.75	1.75
INCOME AND SAVING											
Nominal GNP	Bill. $	6779.6	6871.3	6957.9	7013.6	7092.5	7176.0	7260.6	7341.8	7433.4	7512.8
Nominal GNP	% change	5.9	5.5	5.1	3.2	4.6	4.8	4.8	4.6	5.1	4.3
Nominal personal income		5.4	8.8	7.5	5.0	4.3	5.2	4.9	4.3	4.4	5.1
Real disposable income		3.1	7.5	4.4	.4	2.4	2.3	2.9	-.2	2.7	2.0
Personal saving rate[1]	%	4.1	4.6	5.2	4.7	4.6	4.7	4.9	4.4	4.5	4.5
Corp. profits, IVA&CCAdj	% change	7.2	3.1	.3	-2.2	4.5	8.1	.6	2.9	8.1	-2.8
Profit share of GNP[1]	%	8.2	8.2	8.1	7.9	7.9	8.0	7.9	7.9	8.0	7.8
Federal govt. surpl./def.	Bill. $	-154.0	-161.1	-154.7	-136.4	-150.2	-155.4	-157.3	-131.6	-143.0	-152.6
State/local surpl./def.		23.9	28.8	33.5	26.7	29.9	27.0	29.0	31.4	35.8	35.8
Ex. social ins. funds		-41.4	-36.4	-31.6	-38.2	-34.7	-37.3	-35.2	-32.7	-28.2	-28.2
PRICES AND COSTS											
GDP implicit deflator	% change	1.9	1.3	2.2	2.7	2.6	2.4	2.7	2.4	2.4	2.3
GDP fixed-wt. price index		3.0	2.6	3.1	2.9	3.0	2.9	3.2	2.8	2.8	2.8
Gross domestic purchases fixed-wt. price index		3.5	2.6	2.8	3.2	3.1	2.8	3.1	2.8	2.8	2.8
CPI		3.6	2.2	3.2	3.6	3.2	2.8	2.9	3.0	3.0	3.0
Ex. food and energy		3.1	2.3	3.3	3.6	3.0	3.0	3.1	3.1	3.1	3.1
ECI, hourly compensation[2]		3.3	2.6	2.3	3.4	3.2	3.3	3.3	3.3	3.4	3.4
Nonfarm business sector											
Output per hour		3.2	4.0	.7	-.7	1.0	2.1	1.6	1.5	1.4	1.4
Compensation per hour		3.1	3.5	4.1	2.5	3.3	3.3	3.8	3.0	3.5	3.5
Unit labor cost		-.1	-.6	3.4	3.3	2.3	1.2	2.1	1.4	2.1	2.1

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

Strictly Confidential (FR)
Class II FOMC

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

May 17, 1995

Item	1992 Q1	Q2	Q3	Q4	1993 Q1	Q2	Q3	Q4	1994 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	215.8
Gross domestic purchases	38.8	45.1	47.9	69.8	33.7	41.8	51.1	74.4	64.9	60.7	6.4	201.6	201.0	240.7
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	177.2
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	211.4
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	123.4
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	44.0
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	33.9
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	45.5
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	81.0
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	74.1
Nonres. structures	1.1	-.6	-3.5	-2.1	.9	.1	.2	1.2	4.6	6.9	-21.4	-5.1	2.4	6.9
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	7.0
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	38.6
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	31.0
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	-24.9
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	72.7
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	97.6
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	-9.3
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	-20.7
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	-19.6
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	-1.1
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	11.4

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)

May 17, 1995

Item	1994 Q3	1994 Q4	Projected 1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1993	1994	Projected 1995	1996
Real GDP	52.9	66.8	37.9	12.1	25.3	38.6	28.9	33.3	34.5	33.8	157.3	215.8	113.9	130.5
Gross domestic purchases	58.2	56.9	50.5	14.8	23.2	35.5	25.9	31.2	32.2	28.7	201.0	240.7	124.0	118.0
Final sales	55.1	74.4	24.3	27.7	46.2	32.8	32.7	35.3	35.2	35.8	153.1	177.2	131.0	138.9
Private dom. final purch.	45.4	74.3	40.5	28.3	44.5	32.5	32.2	32.9	31.9	30.0	205.9	211.4	145.8	126.9
Personal cons. expend.	26.9	44.9	12.4	20.7	27.1	18.9	18.9	19.9	20.6	19.4	102.8	123.4	79.1	78.7
Durables	7.4	25.2	-6.6	.2	8.4	2.8	1.8	3.3	3.8	3.5	42.0	44.0	4.8	12.5
Nondurables	9.1	8.5	4.1	5.6	7.2	4.2	5.1	5.1	5.2	5.2	13.8	33.9	21.2	20.6
Services	10.4	11.1	15.0	14.8	11.5	11.9	11.9	11.5	11.6	10.6	47.0	45.5	53.2	45.6
Business fixed invest.	22.1	28.2	31.9	18.6	17.8	11.5	10.6	10.7	10.5	10.3	86.3	81.0	79.8	42.2
Producers' dur. equip.	21.5	24.2	26.7	14.8	14.6	8.6	7.9	8.1	8.4	8.6	83.9	74.1	64.7	33.0
Nonres. structures	.6	4.0	5.2	3.8	3.1	2.9	2.8	2.6	2.1	1.7	2.4	6.9	15.1	9.1
Res. structures	-3.6	1.3	-3.9	-10.9	-.3	2.0	2.7	2.2	.8	.3	16.8	7.0	-13.1	6.0
Change in bus. invent.	-2.1	-7.7	13.6	-15.5	-21.0	5.8	-3.7	-2.0	-.7	-2.0	4.2	38.6	-17.1	-8.4
Nonfarm	-4.3	-5.7	16.6	-14.3	-19.5	6.3	-3.7	-2.0	-.7	-2.0	4.4	31.0	-10.9	-8.4
Farm	2.2	-2.0	-3.0	-1.2	-1.5	-.5	0	.0	0	0	-.2	7.6	-6.2	0
Net exports	-5.2	9.9	-12.6	-2.7	2.1	3.0	3.0	2.1	2.4	5.1	-43.7	-24.9	-10.1	12.6
Exports	22.6	31.4	-1.0	11.2	12.1	14.9	15.6	17.2	17.3	18.0	34.5	72.7	37.1	68.1
Imports	27.9	21.5	11.6	13.8	10.0	11.8	12.6	15.1	14.9	12.9	78.1	97.6	47.2	55.5
Government purchases	14.9	-9.8	-3.6	2.0	-.4	-2.7	-2.5	.3	1.0	.7	-9.1	-9.3	-4.7	-.5
Federal	8.8	-13.1	-3.9	-1.4	-4.0	-4.9	-5.7	-3.1	-2.5	-2.6	-25.9	-20.7	-14.2	-13.9
Defense	6.9	-13.9	-4.0	-.4	-3.7	-1.6	-2.5	-2.8	-2.2	-1.9	-23.7	-19.6	-9.7	-9.4
Nondefense	1.8	.8	.1	-1.0	-.3	-3.3	-3.2	-.3	-.3	-.7	-2.2	-1.1	-4.5	-4.5
State and local	6.1	3.3	.3	3.4	3.6	2.2	3.2	3.4	3.5	3.3	16.8	11.4	9.5	13.4

1. Annual changes are from Q4 to Q4

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

May 17, 1995

Item	Fiscal year				1994				1995				1996			
	1993[a]	1994[a]	1995	1996	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[b]	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1153	1257	1360	1397	289	363	318	308	307	411	335	316	300	430	351	330
Outlays[1]	1409	1461	1526	1586	348	363	371	380	378	386	382	394	401	395	396	410
Surplus/deficit[1]	-255	-203	-166	-190	-59	0	-53	-73	-71	24	-47	-78	-101	35	-45	80
On-budget	-301	-259	-237	-250	-66	-33	-55	-87	-83	-14	-53	-85	-108	-6	-51	84
Off-budget	46	56	71	60	8	33	2	14	12	39	6	7	7	41	6	4
Surplus excluding deposit insurance[2]	-283	-211	-183	-197	-65	3	-57	-77	-77	23	-51	-79	-104	35	-48	-79
Means of financing																
Borrowing	249	185	159	219	51	8	37	60	66	-2	35	85	77	14	44	58
Cash decrease	6	17	5	-29	5	-6	15	9	8	-16	3	-4	20	-45	0	25
Other[3]	0	1	4	-1	2	-2	1	5	-3	-7	9	-3	4	-4	1	-3
Cash operating balance, end of period	53	36	31	60	45	51	36	27	18	34	31	35	15	60	60	35
NIPA FEDERAL SECTOR					Seasonally adjusted, annual rate											
Receipts	1242	1355	1448	1513	1338	1381	1389	1409	1437	1474	1472	1492	1496	1532	1533	1549
Expenditures	1497	1529	1599	1660	1514	1526	1543	1570	1592	1610	1622	1647	1654	1663	1677	1702
Purchases	447	439	433	425	438	435	444	432	433	435	432	427	426	424	423	421
Defense	307	296	285	282	292	292	301	285	284	287	284	283	284	282	280	279
Nondefense	140	144	148	143	146	144	144	147	149	148	148	144	142	142	142	142
Other expenditures	1049	1090	1166	1235	1076	1091	1099	1138	1159	1176	1191	1220	1228	1240	1254	1281
Surplus/deficit	-254	-174	-151	-147	-176	-145	-154	-161	-155	-137	-150	156	-157	-132	-143	-153
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-211	-164	-174	-166	-158	-140	-161	-184	-183	-159	171	-176	-176	-151	-163	-173
Change in HEB, percent of potential GDP	- 1	-.7	2	- 1	- 6	- 3	3	3	0	4	2	1	0	- 3	2	1
Fiscal impetus (FI), percent, cal year	-4 1	-7 3	-6 2	-9 5	-4 2	-4 3	3 4	-3 8	-1 5	-2 1	- 5	-2 7	-5 1	-1 8	1	-2 3

1 OMB's February 1995 deficit estimates are $193 billion in FY95 and $197 billion in FY96 CBO's March 1995 deficit estimates are $175 billion in FY95 and $210 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 February 1995 deficit estimates, excluding deposit insurance spending, are $205 billion in FY95 and $203 billion in FY96 CBO's March 1995 deficit estimates, excluding deposit insurance spending, are $191 billion in FY95 and $218 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

The powerful rally in capital markets witnessed over the intermeeting period was apparently triggered by data indicating more slowing in the economic expansion than market participants had previously anticipated. The soft cast to real side indicators was enough to convince many that the Federal Reserve had written the last chapter in the current episode of policy tightening. Indeed, sentiment has clearly shifted toward the expectation that the next move will be an easing--though the PPI and CPI rose enough in April that such a step is seen as being some months away.

Money-market rates have changed little, on balance, over the intermeeting period, but intermediate- and longer-term Treasury yields have shed roughly 60 basis points. Yields on corporate securities have followed those on Treasuries, preserving their very narrow risk spreads. The drop in market yields has been passed through to mortgage rates, with the thirty-year fixed-rate mortgage yield falling to a fourteen-month low. The prospect of an economic slowdown apparently has not weighed heavily on stock prices: Major equity indexes have risen from 4-1/2 percent to 7 percent over the intermeeting period, reaching new highs. Besides the spur provided by lower interest rates, incoming earnings reports by and large have continued to provide pleasant surprises.

The flows of tax payments and refunds always make it difficult to interpret the behavior of the monetary aggregates at this time of year. However, the staff's assessment is that the catch-up in tax refunds that had been delayed in the first quarter, as well as elevated nonwithheld tax payments, buoyed the growth of liquid deposits last month. Despite the boost from tax-related flows, M1 eked out a rate of increase of just 2 percent in April. Declines in market interest rates apparently made the returns on small time deposits and money market funds appear more favorable, and these components of M2 both posted double-digit growth rates. On net, M2 expanded at a 4 percent rate last month, a bit faster than in March. With banks funding rapid asset expansion, and with institution-only money funds rising steeply as well, M3 expanded at a 6 percent rate in April. The growth of the monetary aggregates relative to that of nominal income appears to have picked up a bit this year. As of April, M2 was a bit below the midpoint of its 1 percent to 5 percent annual range while M3 remained somewhat above the upper bound of its 0 percent to 4 percent annual range.

Bank credit expanded at a 14 percent annual rate in April reflecting brisk growth of both securities and loans. The former, however, was propped up to a significant degree by revaluation of off-balance-sheet positions. The strength in lending in April was widespread, led by robust increases in the business and consumer categories. Although spending on durable goods has softened, the level has remained sufficient to produce a continued hefty demand for credit; the rapid rise in consumer loans at banks last month is consistent with reports of continued aggressive pricing of such loans and the marked willingness of banks to extend credit. Our recent survey of senior loan officers also suggests that terms and standards on business loans have eased even further of late. Business demand for such credit has been elevated, owing importantly to the need to finance the ongoing buildup of inventories and fixed capital. Real estate loans grew at a 9 percent rate last month after expanding at a 12 percent rate in the first quarter; the steep decline in fixed-rate mortgage rates has reduced demand for adjustable-rate loans, which banks are more likely to hold.

As yet, the revival of merger and acquisition activity does not appear to have left a major imprint on bank balance sheets. Although our recent loan officer survey suggests considerable demand for merger-related credit, much of the bank involvement to date has been to provide backup lines of credit. When short-term credit has been necessary, the commercial paper market has proved accommodating, in part because strong inflows into money market mutual funds have increased their appetite for new issues.

Underwriting in the corporate bond market has been lethargic this year, but data for the first weeks of May suggest a stirring in activity as some firms sought to lock in lower market yields. Despite the buoyant stock market, new equity offerings have not picked up much and, in total, have been easily outstripped by share retirements.

Outside of what can be read on bank balance sheets, no current-quarter information is available on credit to the household sector. Total consumer installment credit expanded at a 13-1/2 percent rate last quarter, just a touch less rapidly that it did over the course of 1994. There were few signs of strains associated with that debt load: Although estimates of scheduled mortgage and consumer debt-service payments edged up relative to income over the past two quarters, those measures remained well below their 1989 highs; and, with the major exception of auto loans at finance companies, the readings on loan delinquencies were still low as of a few months ago.

Gross offerings of tax-exempt bonds have continued to be light over the past few months. Issues for new capital have been limited, and municipal yields have not reached levels low enough to make refunding attractive. Retirements of securities that were refunded in advance are estimated to be sizable, and we think that the stock of municipal securities outstanding has fallen about $20 billion since the beginning of the year.

U.S. government debt is now estimated to have increased at a seasonally adjusted 7-3/4 percent pace in the first quarter, but its growth has slowed markedly this quarter. The inflow of tax receipts, up considerably from last year, has allowed the Treasury to replenish its cash balance while refraining from borrowing, on net, in the public market.

Outlook

In preparing its economic forecast, the staff has retained the assumption that the federal funds rate will hold steady at 6 percent over the remainder of 1995 and all of 1996. The extent of the drop in bond yields over the intermeeting period remains somewhat baffling, and we sense that the market may have gotten a bit beyond the fundamentals. We think that bond market participants will come to share that assessment, too, as decent growth in final demand over the coming months and the absence of policy action both fail to confirm their more bullish scenarios for securities prices. In that environment, long-term yields should edge higher over the balance of the year. In 1996, bond yields might rise still further as the economy expands at its potential and growth in net private demands for capital continues to press hard on limited domestic supplies--despite the assumed federal fiscal restraint.

The growth of the broad monetary aggregates has tilted up of late, and it is anticipated to remain on that higher trend through 1996. Moreover, with money market conditions stable for a time, the upward creep of rates on liquid deposits should reduce opportunity costs somewhat, providing a lift to the monetary aggregates. The expansion of M3, at about 4-1/4 percent this year, should be just under that of nominal GDP and then should slip back a bit in 1996.

M2 growth is anticipated to be a little more subdued, and M2 velocity should rise this year and next.

Growth of the debt of the nonfinancial sectors is expected to average a little more than 5 percent this year and about 5 percent in 1996. Growth of federal debt should average 5-1/4 percent in both 1995 and 1996, though the quarterly pattern of federal financing is expected to be volatile. Nonfederal debt, which is anticipated to increase 5 percent this year, will probably slow next year as both businesses and households ease their borrowing.

Despite a substantial drop-off in inventory investment, overall capital spending by nonfinancial corporations over the next year and a half should be strong enough to generate considerable external financing needs; the recent sizable gap between expenditures and internal funds is expected to persist over coming quarters. With longer-term yields remaining below levels reached last year, we anticipate that the recent move toward greater bond financing will be extended. However, bank loans are likely to continue growing at a good clip, given overall borrowing needs--and what we expect will be only a gradual tightening of lending policies. The recent rise in share prices should stimulate some rise in gross equity offerings. But if merger and acquisition activity remains brisk in the quarters to come--and we've assumed it will--the outstanding stock of equities is likely to continue to decline.

In the household sector, spending on durables and housing should be accompanied by at least moderate debt growth. The growth of household debt is expected to come in at 6-1/2 percent in 1995 before edging back to just below 6 percent in 1996. Both mortgage and consumer credit are expected to grow a little faster than nominal personal income, raising households' debt-service burden somewhat. A more cautious attitude on the part of lenders also may emerge, though a radical shift in credit practices is unlikely to develop in the generally favorable economic climate that we've forecast. With unemployment remaining low, delinquencies should not rise sharply, and loan losses should remain subdued.

With spending by states and localities likely to grow only moderately in 1995 and 1996 and much of the heavy volume of issuance from the mid-1980s scheduled to be called, that sector's debt is anticipated to contract for a while. In total, the debt of state and local governments is expected to shrink at rates of 6-3/4 percent and 4-1/2 percent this year and next, respectively, trimming 1/2 percentage point from the average growth of nonfederal debt each year.

Confidential FR Class II
May 17, 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	-0.3	5.0
1994	5.0	4.7	5.2	8.2	6.3	13.6	3.8	-2.9	5.7	6.5
1995	5.2	5.3	5.1	6.5	5.8	9.0	6.5	-6.7	1.0	4.6
1996	4.9	5.3	4.7	5.8	5.8	7.1	5.4	-4.4	1.0	4.8
Quarter (seasonally adjusted annual rates)										
1994:1	5.3	6.3	4.9	7.1	6.2	8.4	3.6	0.7	7.6	6.1
2	4.4	3.6	4.7	7.2	5.5	13.8	3.7	-2.8	6.0	7.2
3	4.9	3.9	5.3	8.7	7.2	13.8	3.9	-4.9	2.0	6.2
4	5.1	4.5	5.4	8.8	5.8	15.8	3.9	-4.8	6.7	6.4
1995:1	5.9	7.8	5.2	6.7	5.7	8.3	6.6	-7.9	1.5	5.1
2	4.4	2.4	5.2	6.5	5.6	9.4	6.6	-7.4	0.6	3.5
3	4.6	3.4	5.0	6.1	5.6	8.8	6.3	-6.4	0.7	4.5
4	5.4	7.1	4.8	6.1	5.7	8.2	5.7	-5.7	1.0	5.3
1996:1	5.8	8.8	4.7	5.9	5.7	7.6	5.5	-5.1	1.0	4.8
2	4.4	3.9	4.6	5.8	5.7	7.1	5.3	-4.8	1.0	4.8
3	4.5	4.1	4.6	5.6	5.7	6.7	5.2	-4.4	1.0	4.9
4	4.4	3.9	4.6	5.5	5.7	6.2	5.1	-3.7	1.0	4.8

1. Data after 1994:4 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 5.0 in 1995 and 5.0 in 1996. Federal debt rises 4.5 percent in 1995 and 5.8 percent in 1996. Nonfederal debt is projected to increase 5.2 percent in 1995 and 4.7 percent in 1996.

2.6.3 FOF

Confidential FR Class II
May 17, 1995

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

	Calendar year			-1994-	-----------1995-----------				-----------1996-----------			
	1994	1995	1996	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
				-----------Seasonally Adjusted Annual Rates-----------								
Net funds raised by domestic nonfinancial sectors												
1 Total	580 4	624.0	649.0	554 7	716.6	521.7	558.7	699 1	772.1	600.8	612.1	611.1
2 Net equity issuance	-40 9	-47.2	-15.0	-102 0	-46.8	-60.0	-50.0	-32 0	-24.0	-14.0	-12.0	-10.0
3 Net debt issuance	621.3	671 2	664.0	656.7	763.4	581 7	608 7	731.1	796.1	614.8	624.1	621 1
Borrowing sectors												
Nonfinancial business												
4 Financing gap[2]	58.4	139.5	135.3	90.2	143.7	141.2	132 7	140.5	133.8	133.4	135 1	138 8
5 Net equity issuance	-40.9	-47.2	-15.0	-102 0	-46.8	-60.0	-50.0	-32.0	-24.0	-14.0	-12.0	-10.0
6 Credit market borrowing	143.3	250.6	221.6	150.7	257.9	261.2	251.0	232.3	225.6	220.9	220.2	219.5
Households												
7 Net borrowing, of which:	351.4	301.5	289.2	397.7	309.4	306.3	294.7	295.4	294 0	290 8	286.6	285 4
8 Home mortgages	187.7	182.5	194.7	180.5	180.0	180.0	183.0	187.0	191.0	193.0	196.0	199.0
9 Consumer credit	117.5	88 1	75.8	149.4	81.9	94.2	90.2	86.2	81.0	78.0	74.0	70 0
10 Debt/DPI (percent)[3]	90.1	90.9	92.0	91.0	91.0	91.7	91.8	92.0	92.1	92.8	92.8	93.0
State and local governments												
11 Net borrowing	-29 3	-64.2	-39.7	-46.6	-75.7	-70.2	-59.2	-51.7	-46.2	42.2	-38.2	-32 2
12 Current surplus[4]	-62.3	-52.3	-49 3	-68.4	-47.3	-54.6	-51.9	-55.3	-53.3	-50.9	-46.5	-46 5
U.S government												
13 Net borrowing	155.9	183.4	193.0	155 0	271.8	84 4	122.2	255 1	322 7	145 3	155.5	148.4
14 Net borrowing;quarterly, nsa	155.9	183.4	193.0	59.7	66.0	-1 7	34 8	84.7	77.3	13.6	43.9	58.2
15 Unified deficit;quarterly, nsa	186.1	171.7	191.3	74.0	71.3	-24.4	46.5	78.3	101.2	-34.9	45.2	79.8
Funds supplied by												
16 depository institutions	197.7	226 9	226.4	197.4	285.5	207.1	205.6	209 5	221 7	225.7	226.7	231 7
MEMO: (percent of GDP)												
17 Dom. nonfinancial debt[3]	188.1	187.9	188.3	188.3	188.7	189.1	189.2	189.3	189 8	189.7	189.5	189.4
18 Dom nonfinancial borrowing	9.2	9.5	8 9	9.5	10 9	8.3	8.5	10 1	10 9	8.3	8 3	8.2
19 U.S. government[5]	2.3	2.6	2.6	2.2	3.9	1 2	1.7	3.5	4.4	2.0	2.1	2.0
20 Private	6.9	6.9	6.3	7.3	7.0	7 1	6.8	6.6	6.5	6.4	6.3	6.3

1. Data after 1994:4 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

The foreign exchange value of the dollar in terms of the other G-10 currencies has risen about 1 percent, on balance, since the March FOMC meeting. During the first three weeks of the intermeeting period, the dollar declined substantially, especially against the yen, prompting heavy intervention by the Bank of Japan and, on two days, substantial U.S. intervention purchases. In mid April, the dollar reached a record low against the yen and a near-record low against the mark bringing its total declines against those currencies since the beginning of the year to 20 percent and 13 percent respectively. Near the end of the intermeeting period, the dollar reversed course strongly, registering increases of 9 percent against the yen and 7 percent against the mark relative to the mid-April lows.

The dollar's weakness for much of the period may have been attributable to the further indications of a softening of U.S. economic activity in the near term. Increasing trade tensions with Japan may have been a factor as well, given market perceptions that the lack of progress might lead the Administration to accept a decline in the dollar against the yen as a way to achieve external adjustment vis-a-vis Japan. Nevertheless, the depreciation of the dollar appeared to have gone beyond what could be justified by news about economic fundamentals. The cessation of the dollar's decline and its subsequent rise may have been helped along by a variety of factors, including improvements in the outlook for the U.S. budget deficit and for economic conditions in Mexico--both of which had been cited as weighing negatively on the dollar in recent months. Other such factors included monetary easing abroad, the completion of the French presidential election and an easing of exchange rate pressures in Europe, repeated statements by G-7 officials that the dollar had overshot on the downside, and clarification that the U.S. Administration would resort to the threat of punitive tariffs in the trade dispute with Japan.

Short-term interest rates in the major foreign industrial countries on average have declined substantially relative to U.S. rates since the March FOMC meeting. Early in the period, the Bank of Japan reduced its discount rate 75 basis points and its overnight call money rate by a total of about 80 basis points, to a level of around 1-1/4 percent. The Bundesbank reduced its discount rate 50 basis points, and German three-month interest rates have declined almost that much; three-month rates in France, Italy, and Canada have declined roughly 100 basis points. Foreign long-term interest rates have declined about 50 basis points on average over the period, not quite as much as U.S. long-term rates.

Financial conditions in Mexico have calmed considerably in recent weeks. The peso appreciated about 15 percent during the first half of April and has since traded in a fairly narrow range just below 6 per dollar. The rate on three-month peso-denominated Treasury bills has declined to about 50 percent, more than 30 points below its peak in mid-March. Mexican stock market prices advanced over the intermeeting period as well and have now reversed more than two-thirds of their decline since the crisis broke in December.

. Intervention by the Desk on April 3 and 5 totaled $1.6 billion against the mark and $1.0 billion against the yen, split evenly between the accounts of the Treasury and the System. The Bank of Mexico drew another $3 billion from the Treasury's Exchange Stabilization Fund (ESF) on April 19 but did not engage in any transactions with the Federal Reserve during the period, although the earlier swap drawing of $1 billion was rolled over at maturity on May 11. Total Mexican drawings outstanding on the ESF now are at $7 billion, and those with the Federal Reserve remain at $1 billion.

The rate of economic expansion in the major foreign industrial countries as a group moderated in the first quarter from the strong pace in 1994, although recent indicators have varied across countries. In Japan, where output remains well below potential, the growth of industrial production slowed to an annual rate of about 5 percent in the first quarter. The Japanese government approved a fiscal stimulus package amounting to 1/2 percent of GDP to finance rebuilding the Kobe area and to help offset anticipated depressing effects of the recent appreciation of the yen. Indicators of production and domestic demand growth in France, Italy, and Canada weakened. However, in western Germany capacity utilization rose during the first quarter, and in the United Kingdom real GDP continued to grow at a fairly strong pace. Preliminary data for Mexican GDP in the first quarter showed a 9.1 percent drop from the fourth quarter level, not seasonally adjusted (in recent years, the decline from the fourth quarter to the first quarter has averaged about 5 percent).

Consumer price inflation remained subdued in the major foreign industrial countries except Italy, where prices have accelerated over the past few months. However, producer price increases in the United Kingdom and Canada and recent wage settlements in Germany point to some increase in underlying inflation pressures in those countries.

The U.S. nominal trade deficit in goods and services widened substantially in January-February from its fourth-quarter level as imports continued expanding while the growth of exports came to an abrupt halt. Despite a significant increase in imports from Mexico, the rate of expansion of imports slowed noticeably from the rapid pace recorded in 1994. The leveling-off of exports reflected the combination of a sharp decline in exports to Mexico and substantial increases in shipments to Japan and other Asian countries. Trade data for March will be released on May 18.

The rate of increase in non-oil import prices slowed significantly in the first quarter, as the prices of imported food and autos declined. The price of imported oil rose moderately in the first quarter, and WTI spot-oil prices have risen to nine-month highs more recently, partly as a result of continued tensions between the United States and both Iran and Iraq. The WTI spot price is currently about $20 per barrel, nearly 5 percent above the level at the time of the March FOMC meeting.

Outlook

We expect real net exports of goods and services to decline somewhat further in the second quarter and then to begin making a net positive contribution to GDP growth. With the downward adjustment of U.S. net exports to Mexico by now probably largely completed and with the additional decline in the dollar earlier this year providing stimulus, we expect the expansion of real net exports to add a little less than 1/4 percentage point to the annual rate of GDP growth over the next six quarters. The depreciation of the dollar should also result in significantly larger increases in non-oil import prices in the near term. This outlook is much the same as the previous one. The growth of real GDP abroad is still expected to slow noticeably this year from last year's pace--primarily because of the recession in Mexico and a sharp slowing of Canadian growth to a more sustainable rate--and to pick up in 1996. The dollar is projected to follow the same path as in the March Greenbook.

The dollar. We project that the foreign exchange value of the dollar in terms of the other G-10 currencies on average will be little changed from current levels through the end of the forecast period. We also expect that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will depreciate moderately, on balance, both this year and next. The sharp real appreciation of the dollar against the peso has already partially reversed, and that process will likely continue, with the peso remaining in the neighborhood of 6 per dollar until later this year and Mexican inflation running well above U.S. inflation. We also expect the dollar to depreciate moderately in real terms against the currencies of the major Asian developing countries.

Foreign G-7 countries. Real GDP growth in the major foreign industrial countries (weighted by U.S. nonagricultural exports) is projected to average between 2-1/2 percent and 3 percent (annual rate) over the forecast period, slightly less than in the March Greenbook.

In Japan, real output is projected to expand moderately over the balance of 1995 and somewhat faster in 1996. We expect that the negative effects of the appreciation of the yen on Japanese real net exports will be about offset by increased stimulus to domestic demand resulting from the recently approved supplementary budget and the easing of interest rates by the Bank of Japan. Real output growth in Germany is projected to average about 2-3/4 percent (annual rate) over the forecast period. The strength of the mark should weaken German net exports, but domestic demand, especially investment spending, is expected to grow fairly strongly. Real GDP growth in Canada, France, and Italy has been revised down somewhat in the near term as recent data have come in weaker than expected in those counties. Even so, growth in all three countries is expected to be at or above potential rates.

Consumer price inflation in the foreign G-7 is projected to remain in the vicinity of 2 percent on average through 1996, although this average masks increasing differences across countries. At one end of the spectrum, recorded Japanese consumer prices are expected to decline at a rate of about 1/2 percent per year as the economy remains well below potential and the effects of the yen appreciation are passed through to domestic prices.[1] At the other end, with Italian GDP projected to approach potential, the cumulative effects of the past depreciation of the lira should push Italian inflation up to 6 percent over the forecast period. For similar reasons and because of a projected rise in interest rates, U.K. headline inflation is expected to increase to nearly 4 percent.[2]

Our forecast assumes that foreign short-term interest rates, on average, will move up from current levels over the forecast period, especially in the United Kingdom and Italy, where the inflation outlook is worsening. Short-term rates in Germany should eventually increase somewhat as well, with output projected to approach potential by the end of 1996. French interest rates should recede from their recent highs as the uncertainty surrounding the recent election subsides, and then could move up a bit as German rates increase. Long-term rates abroad are projected to rise somewhat on average.

Other countries. The real GDP of major developing country trading partners of the United States (weighted by U.S. nonagricultural export shares) is forecast to increase 3-1/4 percent during 1995 and 5 percent during 1996. The forecast for aggregate growth in 1995 has been revised upward by about 1/4 percentage point, mainly because of improved growth prospects for Asian developing economies.

Mexico's real GDP is projected to fall 4 percent in 1995 as a result of fiscal and monetary tightening, sharply reduced net private capital inflows, and increased uncertainty. We expect that the

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1. The actual rate of deflation in Japan could be significantly greater because of measurement error. A recent survey of large-scale discount stores in Japan showed their prices falling at a 6 percent annual rate; unit value indexes show similar declines.

2. The underlying inflation rate should rise somewhat less, but is unlikely to meet the U.K. government's medium-term goal of being within the lower half of the target range of 1 to 4 percent in early 1997.

stabilization of financial markets, now apparently under way, will support a turnaround in real activity by year-end and significant positive growth during 1996. Given the rapid adjustment of Mexico's trade balance early this year, we expect the current account to show a much improved deficit of a little more than $5 billion in 1995 and roughly a zero balance in 1996.

Although financial markets in Argentina have stabilized somewhat over the past two months leading up to the reelection of President Menem, continuing problems in the banking sector and high interest rates have led us to revise down to zero that country's projected real GDP growth in 1995. In Brazil, an unexpectedly strong expansion of output in the first quarter has led us to raise the outlook for that country's GDP growth in 1995. The outlook for Brazil in the longer term remains clouded, however, by the real appreciation of its currency of about 30 percent since mid-1994 and by the government's limited success in implementing fiscal reforms. On average, we expect GDP in our major Latin American trading partners to decline a little over 1 percent over this year but to rise by 2-1/2 percent next year, about the same as in the March Greenbook.

We project that growth in our major Asian developing-country trading partners will average nearly 7 percent this year and next. This forecast is somewhat stronger than our previous projection because of the additional stimulus to net exports that many of these countries are likely to gain as a result of recent depreciation of their currencies vis-a-vis the yen.

U.S. real net exports. With the downward adjustment of Mexico's external deficit now largely completed, we expect the growth of U.S. real exports of goods and services to pick up fairly strongly over the period ahead. We expect the effects of the recent depreciation of the dollar against G-10 currencies on average to help push real export growth close to a 10 percent rate by 1996. Growth of real GDP and especially fixed investment in most of our major export markets in Europe and Asia will further support the expansion of exports. Notwithstanding this acceleration, the projected growth of exports is noticeably lower than the rate of expansion in 1994. Some of this slower export growth can be attributed to the projected slowing of growth abroad. More importantly, export growth in 1994 exceeded what could be explained by historical relationships. To the extent that these relationships may have changed, there is some risk that export growth will exceed our predictions again in 1995 and 1996.

QUANTITIES OF GOODS AND SERVICES*
(percent change from end of previous period, saar)

		-------Projection-------			
	1994	1995			1996
		Q1	Q2	H2	
Exports of G&S	11.6	-0.6	6.6	7.3	9.3
of which:					
Services	4.6	-4.3	7.8	6.6	5.1
Computers	29.5	16.8	26.1	26.1	26.2
Other goods[1]	10.3	-2.9	3.8	3.8	6.5
Imports of G&S	13.8	5.9	6.9	5.3	6.5
of which:					
Services	1.4	11.5	-0.6	1.1	2.8
Oil -1.7	10.7	25.9	9.4	0.1	
Computers	36.3	2.8	31.1	22.8	20.4
Other goods[2]	14.0	7.4	1.2	1.3	4.0

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

We expect non-oil imports other than computers to decelerate sharply for the balance of 1995 as a result of the combined effects of the depreciation of the dollar and the substantial slowing of growth in U.S. domestic demand. These factors are expected to reduce the growth of non-oil imports excluding computers substantially for the balance of 1995; these imports should resume expanding somewhat faster than GDP during 1996. Imports of computers are projected to bounce back in the near term from an unexpected deceleration in the first quarter and then to grow about in line with domestic expenditures on office and computing equipment in real terms. Our forecast does not assume that sanctions will actually be imposed on Japanese luxury cars; to that extent there is some downside risk to our import forecast, although in the event of full imposition of the sanctions, reduced imports from Japan likely would be at least partly offset by increased imports from Europe. On the other hand, there is some upside risk to the import forecast since, like exports, imports grew substantially faster in 1994 than could be explained by historical relationships.

The quantity of oil imports should rise in the current quarter as seasonally higher consumption and inventory accumulation set in. During the remainder of 1995, oil imports are projected to remain on an upward trend as U.S. oil consumption keeps pace with economic activity and domestic production resumes its decline.

Oil prices. As a result of the recent increase in spot oil prices, we have revised up our path for oil import prices in the near term. We are assuming that the WTI spot price will average about $20 per barrel in the second quarter and will fall to $18.50 per barrel by the fourth quarter as GDP growth in North America slows and world oil production picks up. This pattern of spot prices is consistent with an oil import price that falls from a little over $17 per barrel in the second quarter to $16 per barrel by year-end. Oil prices should remain in that vicinity, assuming that Iraq returns to the world oil market in 1996.

Prices of non-oil imports and exports. The prices of U.S. non-oil imports other than computers are expected to rise substantially in the second quarter, at a rate of about 5 percent in the second half of 1995 and at about half that rate during 1996. These prices will be boosted in the near term by the lower value of the dollar. Prices of non-agricultural exports other than computers are projected to decelerate over the forecast period, in line with the slowing in U.S. domestic prices of tradable goods.

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

		-------Projection------			
	1994	1995			1996
		Q1	Q2	H2	
US domestic prices[1]	3.5	5.5	5.7	2.9	2.2
Nonag. exports[2]	4.9	9.5	5.8	3.2	2.3
Non-oil imports[2]	3.9	3.5	6.5	4.6	2.3
Oil imports (Q4 level, $bl)	15.41	16.02	17.15	16.13	16.00

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

Nominal trade and current account balances. The nominal trade deficit on goods and services is expected to widen through mid-1995 and then to narrow over the rest of the forecast period. The deficit on net investment income is projected to increase. As a consequence, the current account deficit will increase this year to about $190 billion and will remain about that rate next year, approximately 2-1/2 percent of GDP.

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May 17, 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	5.6	2.6	2.6	6.6	5 6	5.9	3 2	2 1	2.3	2.6
France	-1.0	3.7	2.8	3.4	5 1	3.3	2.6	1 8	3.2	3.2	3.2
Germany	-0.1	4.0	2.6	2.9	4.2	4.4	4.0	2.2	2.5	2 8	2 9
W. Germany	-0.5	3.3	2.0	2.4	3.6	4.2	3.0	1.2	2.2	2 4	2.4
Italy	-0.2	2.7	3.3	3.5	4 0	5.4	0.1	2.0	3.3	3 8	4 0
Japan	-0.5	0.9	2.2	3 1	0.7	3.5	-3.4	0.7	2.8	2.8	2.5
United Kingdom	2.6	4.2	3.0	2.7	5.6	3.7	3.1	3.1	2.9	3.0	3.0
Average, weighted by 1987-89 GDP	0.3	2.9	2.6	3.1	3.5	4.1	0 8	1.8	2.8	3.0	3.0
Average, weighted by share of U.S. nonagricultural exports											
Total foreign	2.8	4.3	2 9	3.5	NA	NA	NA	NA	NA	NA	NA
Foreign G-7	1.6	4.1	2.6	2.8	4.8	4 6	3 0	2 4	2 5	2 7	2 8
Developing countries	5.5	5.1	3.3	4.9	NA	NA	NA	NA	NA	NA	NA
CONSUMER PRICES(1)											
Canada	1.8	0.0	3.0	2.4	-1.4	2.2	1.3	4.2	3.5	2.4	2.0
France	2.1	1.6	1.6	1.5	2.5	0.6	1.7	2.2	1.1	1 5	1 4
Western Germany	3.7	2.8	2.4	2.5	2.7	1.4	1.3	3.8	2.3	1.8	1.7
Italy	4.1	3 8	5.8	6.0	3.4	3.0	4.7	6.1	8.2	3.4	5.6
Japan	1.2	0.8	-0.5	-0.5	1.3	-0.9	2.1	-2.3	0.7	0.0	-0.1
United Kingdom	1.6	2.6	3.7	3.8	7.4	0.1	2.6	3.6	7 6	1.2	2.4
Average, weighted by 1987-89 GDP	2.2	1.8	2 0	2.0	2.6	0.6	2.3	1 9	3.3	1.3	1.7
Average, weighted by share of U.S. non-oil imports	1.9	1.1	1.7	1 5	1.1	0.7	1.9	1.5	2.6	1.3	1.3

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 0	-151.3	-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	-148 2	-166.9	-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	50.9	60.3	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	-3.3	-11 3	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 8	43.4	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	-28.4	-33 5	6.7	-32 0	-32.1

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

Strictly Confidential (FR) Class II-FOMC

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

(Billions of dollars, seasonally adjusted annual rates)

	1994		Projection 1995				1996				Projection ANNUAL		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1994	1995	1996
NIPA Real Net Exports of Goods & Services (87$)	-117.0	-107.1	-119.7	-122.4	-120.3	-117.2	-114.2	-112.1	-109.7	-104.6	-110.0	-119.9	-110.2
Exports of G&S	666.5	697.9	696.9	708.1	720.2	735.0	750.6	767.8	785.1	803.1	657.0	715.0	776.7
Goods	505.1	533.6	534.4	542.5	551.8	564.0	577.5	592.4	607.6	623.4	496.9	548.2	600.2
Agricultural	40.7	45.9	45.9	44.3	43.8	44.6	45.2	45.8	46.4	47.0	40.2	44.7	46.1
Computers	85.9	95.8	99.6	105.6	111.9	118.6	125.7	133.2	141.2	149.7	84.5	108.9	137.5
Other Goods	378.5	391.8	388.9	392.6	396.1	400.8	406.6	413.4	420.0	426.7	372.2	394.6	416.7
Services	161.3	164.3	162.5	165.6	168.4	171.1	173.1	175.4	177.5	179.7	160.0	166.9	176.4
Imports of G&S	783.5	805.0	816.6	830.4	840.4	852.2	864.8	879.9	894.8	907.8	766.9	834.9	886.8
Goods	674.6	695.9	704.5	718.5	728.5	739.7	751.6	766.0	780.0	792.1	658.5	722.8	772.4
Oil	64.3	57.1	55.5	58.8	61.7	61.5	60.9	62.3	63.3	61.5	59.6	59.4	62.0
Computers	115.4	128.9	129.8	138.9	146.6	153.9	161.6	169.7	177.3	185.3	112.7	142.3	173.5
Other Goods	494.9	510.0	519.2	520.8	520.3	524.3	529.1	534.0	539.4	545.3	486.2	521.2	536.9
Services	108.9	109.1	112.1	111.9	111.9	112.5	113.3	113.9	114.8	115.7	108.5	112.1	114.4
Memo: (Percent change 1/)													
Exports of G&S	14.8	20.2	-0.6	6.6	7.0	8.5	8.8	9.5	9.3	9.5	11.6	5.3	9.3
Agricultural	38.8	61.8	0.0	-12.9	-4.7	7.7	5.4	5.3	5.2	5.0	17.4	-2.8	5.2
Computers	37.7	54.7	16.8	26.1	26.2	26.2	26.2	26.2	26.2	26.2	29.5	23.8	26.2
Other Goods	12.2	14.8	-2.9	3.8	3.7	4.8	5.9	6.9	6.5	6.6	10.3	2.3	6.5
Services	5.4	7.6	-4.3	7.8	6.8	6.6	4.9	5.3	4.9	5.1	4.6	4.1	5.1
Imports of G&S	15.6	11.4	5.9	6.9	4.9	5.7	6.0	7.1	7.0	5.9	13.8	5.9	6.5
Oil	29.3	-37.8	-10.7	25.9	21.2	-1.3	-3.6	9.7	6.1	-10.5	-1.7	7.7	0.1
Computers	35.8	55.7	2.8	31.1	23.9	21.6	21.6	21.6	19.3	19.3	36.3	19.4	20.4
Other Goods	12.1	12.8	7.4	1.2	-0.4	3.1	3.6	3.8	4.1	4.4	14.0	2.8	4.0
Services	5.7	0.7	11.5	-0.6	-0.2	2.3	2.7	2.1	3.3	3.0	1.4	3.2	2.8
			Projection										
Current Account Balance	-163.4	-179.9	-181.6	-193.5	-190.5	-203.2	-188.5	-190.8	-184.9	-197.9	-155.9	-192.2	-190.5
Goods & Serv (BOP), net	-115.0	-107.5	-120.5	-127.6	-126.1	-119.5	-114.1	-111.0	-107.7	-102.0	-106.6	-123.4	-108.7
Goods (BOP), net	-178.5	-172.7	-181.5	-191.8	-194.2	-190.8	-187.8	-187.2	-186.3	-183.2	-166.6	-189.6	-186.1
Services (BOP), net	63.5	65.2	61.0	64.2	68.1	71.2	73.7	76.2	78.6	81.2	60.0	66.1	77.4
Investment Income, net	-16.1	-30.0	-29.1	-33.9	-32.4	-41.2	-41.9	-47.3	-44.7	-52.8	-15.2	-34.1	-46.7
Direct, net	40.7	35.6	38.5	41.2	42.1	42.1	43.0	44.3	45.6	45.6	41.4	41.0	44.6
Portfolio, net	-56.9	-65.7	-67.6	-75.1	-74.5	-83.3	-84.9	-91.6	-90.4	-98.4	-56.6	-75.1	-91.3
Unilateral Transfers, net	-32.3	-42.3	-32.0	-32.0	-32.0	-42.5	-32.5	-32.5	-32.5	-43.0	-34.1	-34.6	-35.1

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