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# Part 1

September 24, 1997

## CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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### **Summary and Outlook**

Prepared for the Federal Open Market Committee

By the staff of the Board of Governors of the Federal Reserve System

Strictly Confidential (FR) Class II FOMC

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September 24, 1997

## **SUMMARY AND OUTLOOK**

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## Domestic Developments

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### Overview

Once again, the incoming information on the economy's performance has provided some pleasant surprises. Real GDP grew considerably more in the second quarter than we had thought, mainly because of impressive, ongoing strength in exports. And although GDP may have decelerated during the current quarter, activity still seems to be expanding faster than we predicted in the August Greenbook. Meanwhile, there have been few signs that the pressures on resources are resulting in any pickup in wage or price inflation.

The financial markets have greeted this news enthusiastically, pushing bond yields back close to their 1997 lows and stock prices, overall, to new highs. Investors seem increasingly enthralled by the "New Era" view--that we are in an extended period of much-improved trend growth, propelled importantly by technological advance and by revolutionary changes in the economies of the developing world, with inflation no worse than a remote risk because of intensified competition.

It is far from clear to us at this juncture that what has occurred requires that we scrap our existing analytical approach. Indeed, for all the talk of a new "paradigm" to go with the New Era, we have not seen a fully articulated, alternative macroeconomic model. It may be that little more is really required to understand the recent phenomena than some new parameters for our standard model, rather than a full-fledged new paradigm. Even in this regard, however, some caution is warranted. The ongoing strength of domestic demand may simply be a conventional response to an irrationally exuberant stock market--a risk that we have often identified in the outlook. And by many analysts' reckoning, the favorable inflation path of the past year can be largely, if not entirely, explained by the substantial appreciation of the dollar. Nonetheless, in what we hope is a judicious response to the incoming news, we have made some further modifications to our projection, incorporating a somewhat more optimistic view of productivity prospects and of the likely near-term response of wages and prices to given levels of resource utilization.

We expect that real GDP growth will average a little less than 3 percent over the second half of 1997 and the first half of 1998. This is a considerable upgrading from the last forecast, in which growth averaged 2-1/4 percent. The revision reflects both the favorable financial market developments of the intermeeting period and the indications of greater-than-expected ongoing thrust from exports and business fixed investment. The strength in these sectors, in turn, is likely to have positive multiplier effects on other components of demand. However, the appreciation of the dollar will gradually sap some of the energy from export demand, and capital spending is likely

to be damped eventually by a waning of accelerator effects, flattening cash flows, and what we anticipate will be a less stimulative financial environment emerging next year. As a consequence, we are projecting that growth will slow appreciably over the latter half of 1998 and remain low in 1999, averaging little more than 1-1/2 percent, at an annual rate, over the six quarters.

With this new forecast contour, output grows fast enough to push the unemployment rate down to around 4-1/2 percent next spring versus 4-3/4 percent in the last Greenbook, and even with the subsequent slackening of the expansion, the unemployment rate remains below 5 percent through 1999. Despite the generally higher level of resource utilization this time, however, the path of inflation is somewhat lower in this forecast than in the last.

We still think that the tightness of the labor market and a peaking of the exchange value of the dollar will likely lead to a rise in inflation, but recent news on wages and prices has prompted us to trim, again, the dimension of the step-up. In particular, we are impressed by the degree to which the expansion of plant capacity in manufacturing, along with foreign competition, seems to be muting price increases in the goods sector. These competitive pressures, and the diminution of inflation expectations, also appear to be putting a damper on wages: Although there are many reports of companies boosting compensation to attract or retain scarce workers, the available aggregate statistics provide no evidence of a general ongoing acceleration, suggesting that pay increases are being given more selectively (or in less visible forms) than in the past. In any event, we have tempered the response of wages to the low level of unemployment. The dollar does not begin to depreciate until later in this forecast, so that the disinflationary pressures from falling import prices do not abate so quickly.

All told, we are predicting that published core CPI inflation, which has been 2.3 percent in the past twelve months, will rise to 2.6 percent next year and 2.8 percent in 1999. This acceleration in each year is damped about 0.2 percentage point by technical changes to the index.

### **Key Background Factors**

With inflation and inflation expectations having come down as they have, real interest rates do not look low by historical standards. Nonetheless, financial factors overall do not appear to be exerting a drag on spending growth at this time. Credit is readily available, and the cost of equity capital is low. Indeed, the mood of the markets at this point seems to be such that the near-term behavior of the economy may not

prevent an extension of the recent bond market rally--although we are not anticipating that to occur. In our forecast, we have assumed a shock to the markets of at least modest proportions, in the form of an upturn in the federal funds rate by next spring; the tightening begins a little earlier and ultimately amounts to somewhat more than that assumed in the last few Greenbooks. We project that intermediate- and long-term interest rates will drift upward through next year, producing a flatter yield curve than now prevails.

Based on previous performance, our stock market prognostications should have little credibility at this point. Nevertheless, we feel obliged to say something on this score because we believe that equity prices are a significant element in the economic outlook. Price-earnings multiples for major market indexes are historically high today, at a time when profits stand at record levels; in the past, the highest PEs tended to occur around cyclical troughs in earnings. Only recently have analysts and investors manifested any doubts that large companies can indefinitely sustain double-digit profit gains against a backdrop of moderate nominal GDP expansion. But the market seems still to be demanding little, if any, compensation for the risk that something might go awry with the New Era economic scenario. In our forecast, there are some significant surprises, including disappointing profits and, probably at least as important, the currently unanticipated tightening of monetary conditions; so we are predicting that share prices, after wavering in the next few months, will turn down substantially in 1998.

Federal fiscal policy likely will be providing no major impulses--positive or negative--to aggregate demand during the forecast period. We are assuming that the 1998 appropriations bills will keep things in line with the recent fiscal agreement. Although there is a risk that the good news on revenues will stimulate proposals for spending increases or further tax cuts, we have not assumed any additional policy actions in the projection. We now expect the unified budget deficit for fiscal 1997 to come in at \$28 billion, somewhat below our previous estimate. With the higher path for nominal GDP likely to boost revenues over the forecast period, we have also lowered the projected deficit for fiscal 1998 to \$51 billion, and we are projecting \$50 billion in fiscal 1999.

The dollar has experienced quite mixed movements recently against various currencies since the last FOMC meeting. On a trade-weighted basis against other G-10 currencies, it has declined somewhat. With our interest rates now projected to rise considerably over the next year or so, we have the G-10 dollar index holding steady over 1998 and then edging downward in 1999. This trajectory contrasts sharply

with the 20 percent rise over the past two years. With regard to foreign activity, a weaker outlook for Asian economies is roughly offset by stronger growth elsewhere; on net, growth in aggregate foreign GDP is expected to remain close to 4 percent in 1998 and then to edge down to 3-3/4 percent in 1999. Although supply disruptions have boosted crude oil prices relative to our expectations in the August Greenbook, our longer-term projection still calls for the spot price for West Texas intermediate oil to decline somewhat over the rest of this year and then to rise about \$0.75 per barrel in 1998; an additional \$1.50 per barrel increase is anticipated for 1999.

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

The BEA's preliminary estimate of second-quarter GDP growth was 3.6 percent at an annual rate, well above the 2.6 percent figure in the August Greenbook. We see no reason to expect a significant revision in the "final" estimate that will be released this Friday. The biggest surprise relative to our forecast (and relative to BEA's advance estimate) was in exports, as the June figures showed an unexpectedly large increase. In addition, nothing in the incoming data leads us to expect a downward revision to the very high second-quarter inventory investment number--in contrast to our speculations in the last Greenbook.

We expect real GDP growth to slow to about 2-3/4 percent at an annual rate in the third quarter, a little below the 3-1/2 percent average pace over the past year and a half but appreciably above the forecast in the August Greenbook. On the production side, hiring has remained brisk, and recent data would suggest that manufacturing output will post a large gain this quarter, perhaps approaching 7 percent at an annual rate.

In addition, domestic final demand appears to be growing rapidly. In the household sector, booming employment, rising income and wealth, and favorable sentiment have been lifting consumer demand, as expected. Healthy gains in motor vehicle and other retail sales through August have prompted us to maintain our prediction of a better than 4 percent increase in real PCE this quarter.

We also have little altered our projection for residential investment, which we estimate will decline about 4-1/2 percent at an annual rate this quarter. Starts of single-family homes were recently revised upward a bit for June and July, but they fell sharply in August, and permit issuance appears to have drifted lower. Given that indicators of demand have remained quite bullish and that inventories of unsold new homes are lean, we are expecting a rebound in starts in September.

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

Measure	1997:Q2			1997:Q3	
	Aug. GB	BEA prel.	Sept. GB	Aug. GB	Sept. GB
<b>Real GDP</b>	<b>2.6</b>	<b>3.6</b>	<b>3.6</b>	<b>2.2</b>	<b>2.8</b>
Private domestic final purchases	2.8	3.0	3.1	5.0	5.9
Personal consumption expenditures	.8	1.0	1.1	4.2	4.1
Residential investment	7.5	7.1	7.5	-5.0	-4.6
Business fixed investment	15.3	15.4	15.5	14.6	22.9
Government outlays for consumption and investment	3.7	3.1	3.2	-.5	-.1
	Change, billions of chained (1992) dollars				
Inventory investment	7.2	14.1	13.1	-24.9	-19.4
Net exports	-17.9	-6.4	-6.6	-9.2	-20.0

Growth in real business fixed investment is now projected to top 20 percent (annual rate) in the current quarter--the biggest increase in more than a decade. Gains in this sector continue to be led by investment in office and computing equipment; shipments have been rising in nominal terms, and prices have been plummeting, so growth in real outlays appears likely to exceed 50 percent (annual rate) this quarter. Meanwhile, data on construction put in place through July point to a likely rebound in outlays for nonresidential structures this quarter.

In contrast to the strength in domestic final demand, the book-value inventory figures for July are consistent with our notion that the rate of stock accumulation will drop back considerably. For manufacturing and trade, excluding motor vehicles, the annualized rate of stockbuilding in July was \$26 billion, versus an average of nearly \$50 billion in the second quarter. Although we have raised our prediction of inventory building for the current quarter as a whole, the deceleration is still expected to subtract more than a percentage point from GDP growth.

Net exports are also projected to fall substantially--much more than in the last forecast. The trade deficit widened considerably in July; exports appear to be holding up well after the second quarter's upside surprise, but strong domestic demand is apparently sucking in huge volumes of imported goods.



Incoming data on prices have been a tad softer than we had expected. The CPI rose another 0.2 percent in August, despite larger increases in food and energy prices than in previous months; excluding food and energy, the increase in August was only 0.1 percent. Although the unexpectedly small rise in August partly reflected special factors that will likely be reversed in September (especially the declines in apparel prices and airfares), increases in both the total CPI and core prices are now projected at about 2 percent (annual rate) this quarter, about 1/4 percentage point below our previous projection. With regard to wages, the twelve-month change in average hourly earnings has held steady in the 3-1/2 percent to 3-3/4 percent range recently; with the higher minimum wage taking effect on September 1, we think that this measure will move back to the upper end of that range in the next couple of monthly readings.

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

The forecast has real GDP growth holding around 3 percent in the fourth quarter, bringing growth for the year to 3-1/2 percent. Output is projected to expand 2-1/4 percent in 1998 and 1-1/2 percent in 1999. As noted earlier, the 1997-98 projection is somewhat stronger than in the last Greenbook. The upward revision to our near-term forecast reflects mainly our expectations that the surge in business fixed investment will tail off more gradually than we had thought previously and that, given the stronger trend of final sales, the downshift in the pace of inventory accumulation will be spread over a longer span.

As was also noted earlier, our forecast of a deceleration in GDP still hinges on the same fundamental arguments we presented in previous Greenbooks. Although the recent strength of exports has prompted us to raise our forecast for this component of GDP, the lagged effects of the appreciation of the dollar still lead us to project a decline in net exports throughout the forecast period. In addition, the already high levels of spending on consumer and producer durables, and the implied stock-flow relationships, suggest some restraint on outlay growth from here. Our assumption of a considerable rise in interest rates and a sizable stock market correction is also key in the damping of aggregate demand, especially in the latter part of 1998 and in 1999. All told, we now expect final sales growth to slow from around 3-3/4 percent over the second half of this year to 2-1/2 percent in 1998 and 1-1/2 percent in 1999.

With real GDP growth remaining above its potential rate--which we now put around 2-1/4 percent--through the first half of next year, labor markets are projected to

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

Measure	1997:H1	1997:H2	1998	1999
<b>Real GDP</b>	<b>4.3</b>	<b>2.9</b>	<b>2.3</b>	<b>1.5</b>
Previous	3.7	2.3	2.0	...
Final sales	3.0	4.0	2.5	1.6
Previous	2.6	3.4	2.0	...
PCE	3.2	3.8	2.8	1.7
Previous	3.0	3.7	2.6	...
Residential investment	5.4	-1.7	-2.6	-2.2
Previous	5.4	-1.6	-2.6	...
BFI	10.0	14.5	7.9	5.6
Previous	9.6	9.3	5.9	...
Government purchases	1.4	.3	.7	.7
Previous	1.6	.6	.7	...
Change, billions of chained (1992) dollars				
Inventory change	43.8	-31.9	-15.1	-11.2
Previous	37.9	-40.6	-.7	...
Net exports	-27.3	-12.1	-30.0	-22.4
Previous	-38.6	-5.6	-37.5	...

... Not applicable.

tighten further.<sup>1</sup> Employers are likely to find that they must pay more for labor, and though we do not anticipate a significant shift in inflation psychology, we doubt that all of these cost pressures will be absorbed in the profit share; rather, there will be a gradual upcreep in the trend rate of price increase.

**Consumer spending.** Real PCE is projected to rise about 3-1/2 percent this year, with growth slowing to 2-3/4 percent next year and 1-3/4 percent in 1999. In the near term, the moderation in inventory investment is expected to take some of the steam out of overall production and income growth, but financial factors become a significant influence as time passes. Given our forecast of the stock market, the household wealth-to-income ratio will be declining throughout the forecast period, but especially during 1998. Our rule of thumb, derived from various econometric

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1. We had failed previously to take account of the effects of technical changes in the CPI on the estimation of real output. The correction adds 0.1 percentage point to growth in both actual and potential GDP in 1998 and 0.2 percentage point in 1999.

formulations, suggests that something like 60 percent of the effect of a change in wealth should be expected to occur within the first year, so the rise in the market to date can be expected to provide impetus to expenditure for some time. Indeed, not until 1999 does this model imply that wealth will become a meaningful restraining influence on consumption, given our stock market forecast. We have, in effect, accelerated the drag a little because we think that a substantial downturn in the market may put a considerable dent in the extraordinary optimism prevailing among households, as they are confronted with the painful possibility that they may have to work at building their nest eggs for tuition and retirement the hard, old-fashioned way--by saving out of current income.

As noted, an additional consideration in our longer-run consumption forecast is the potential for a downward adjustment from the rapid rate of accumulation of consumer durables evident in recent quarters. To be sure, ongoing price declines and the introduction of new products will likely continue to propel rapid growth in spending on consumer electronics. But sales of light vehicles have been running at a fairly high level for some time and are likely to drift lower. Similarly, especially in light of our forecast for housing starts, spending on traditional household goods such as furniture and appliances is anticipated to decelerate in coming quarters.

**Residential investment.** We are projecting a moderate decline in residential investment over the forecast period. For the near term, many of the basic factors conditioning demand are still quite positive: Job and income growth have been solid, household wealth is high, and consumers report homebuying conditions (especially mortgage rates) to be very good. Consequently, we feel reasonably comfortable in discounting last month's drop-off in single-family building and anticipating that such starts in the next several months will move back above the 1.1 million unit mark. However, as mortgage rates and other fundamental determinants become less favorable next year, some erosion of demand is likely, although we expect only a relatively mild decline in construction activity in what will still be a very high employment economy with a historically low cash-flow burden of homeownership. All told, we are predicting that single-family starts will be dropping only to 1.08 million units in 1999 from 1.13 million this year.

Multifamily starts have essentially been on a plateau for some time now, well above the previous cyclical trough level but well below the peaks of past decades. With the movement to conventional single-family houses and manufactured homes, the apartment vacancy rate has come down only a little in the past year, and rents in many markets have not been strong enough to inspire a great deal of building. Given the

economic and financial outlook, we expect a moderate decline in multifamily starts, to 290,000 per year by 1999 from 310,000 in 1997.

**Business fixed investment.** Growth of real business fixed investment is expected to drop back to a 6-1/2 percent annual rate in the final quarter of 1997 from the extraordinary gains posted in the second and third quarters. However, much of this projected slowing simply reflects a bunching of motor vehicle fleet sales and aircraft purchases this summer, and the average annual growth rate in the second half of the year--at almost 15 percent--probably gives a better sense of the current underlying pace of investment growth. With sales growth projected to weaken and corporate cash flow coming under increasing pressure, we expect that real BFI growth will slow to around 8 percent in 1998 and 5-1/2 percent in 1999.

Investment in high-tech equipment should continue to grow rapidly, driven by continued sharp price declines and technological innovations. Outlays for office and computing equipment are projected to rise 30 percent or more in 1998 and in 1999. While "Year 2000" reprogramming costs may strain some companies' information system budgets, many firms may find earlier replacement of older equipment a cost-effective way of addressing some of that special problem. We are also projecting continuing double-digit increases in outlays for communications equipment, where advances in wireless technologies and the opening of markets should continue to spur capacity growth.

The macroeconomic influences we have built into this projection are likely to be more discernible in other categories of equipment spending. We have raised our projection for growth of noncomputer, non-communications equipment a bit in 1998, reflecting the stronger growth in output now expected for next year. Nevertheless, with sales decelerating and rising interest costs exacerbating pressures on cash flow, we anticipate that growth in outlays for these types of equipment will slow markedly--to virtually zero by the end of the projection period. In light of the projected deceleration in capacity utilization, we are forecasting a drop in the absolute level of manufacturing investment.

After a sharp rebound in the current quarter, increases in outlays for nonresidential construction are projected to settle in at about a 3 percent pace in 1998 and 1999. New construction contracts have leveled off overall this year, but anecdotal reports on activity are more upbeat, and the underlying factors that typically influence construction spending appear relatively favorable at this point. In particular, vacancy rates remain low, prices for commercial real estate have been rising, and financing for new projects is readily available and likely to remain so for a while. Although we are

projecting that longer-term rates will be rising, they stay in the range of the past year, and, given the long lags in construction in this sector, the rise should not exert much of a drag on building within the projection period.

**Inventory investment.** As noted previously, we have raised the near-term inventory investment forecast somewhat. Although we continue to believe that businesses eventually will want to reduce stockbuilding to a pace more consistent with trend GDP growth, in the current environment of strong final demand and with no overhang, a somewhat higher rate of accumulation may well be desired. As sales slacken over the course of next year, there could be some unplanned buildup of stocks, but we have assumed that businesses will get on top of any problems very quickly. Broadly, nonfarm inventory investment slows in step with final demand through 1999.

**Government spending.** Real federal expenditures for government consumption and gross investment are expected to decline at a 1-3/4 percent annual rate in the fourth quarter. This drop is larger than was projected in the last Greenbook, reflecting some changes in the timing of defense purchases (the decline in the third quarter evidently being smaller than we had expected). For 1998, the forecast is little changed, with federal purchases projected to decline 2 percent; a similar decline is projected in 1999. We anticipate that real nondefense purchases will rise about 1 percent next year but turn down in 1999, reflecting the discretionary spending caps. Defense spending is projected to decline 3-1/2 percent next year and 2-3/4 percent in 1999.

Real purchases by state and local governments are projected to rise 2-1/4 percent, on average, over the forecast period, similar to the average gains in recent years. Although the financial position of most states has continued to improve, there seems to be no move on the part of public officials to up the pace of outlays. The impact of welfare reform continues to add an element of caution in state and local spending and uncertainty to our projection; however, with unemployment rates anticipated to remain low in most areas, the likelihood of significant pressures on state funds from social programs seems remote.

**Net exports.** Real exports of goods and services, which we now expect to run close to 12 percent this year, is projected to increase only 7-1/2 percent in 1998. The growth of imports is expected to slip next year as well, reflecting the slower growth in U.S. activity. On net, declining real net exports are projected to subtract roughly 1/3 percentage point per year from GDP growth in 1998 and 1999. (A fuller discussion of the prospects for the external sector is contained in the *International Developments* section.)

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

Measure	1996	1997	1998	1999
Output per hour, nonfarm business	1.2	1.8	1.0	.9
Previous	1.2	1.0	.8	...
Nonfarm payroll employment	2.1	2.3	1.7	.8
Previous	2.1	2.2	1.4	...
Household employment survey	2.1	2.2	1.5	.7
Previous	2.1	2.2	1.3	...
Labor force participation rate <sup>1</sup>	66.9	67.2	67.4	67.3
Previous	66.9	67.2	67.3	...
Civilian unemployment rate <sup>1</sup>	5.3	4.7	4.5	4.9
Previous	5.3	4.7	4.7	...

1. Percent, average for the fourth quarter.

... Not applicable.

**Labor markets.** Reflecting the upward revision to GDP growth over the second half of this year, we have boosted our near-term forecast for labor demand. Gains in nonfarm payrolls are now expected to average more than 200,000 per month over the fourth quarter, before gradually decelerating to about 110,000 per month by the end of next year and less than 100,000 per month in 1999. We anticipate that the near-term strength in labor demand will attract some additional workers into the labor force, and thus we continue to project that the labor force participation rate will begin to move up again. However, we do not think that the reserve of inactive, yet qualified, individuals is sufficient to fully meet the added demand, and thus we foresee the unemployment rate falling to 4-1/2 percent by next spring.

The decline in unemployment would have been even greater had we not also raised our projection for labor productivity growth in the second half of 1997 and in the first half of 1998 to about 1-1/2 percent. Output per hour posted an unexpectedly large increase in the second quarter, suggesting that--despite the prevalence of reports of difficulty in finding qualified workers--there were as yet no insurmountable problems of lesser quality. Taking a somewhat more optimistic view of productivity prospects in light of the recent experience, we have raised our forecast of productivity growth over the next few quarters by more than typically would be consistent with the revision to output growth. Productivity growth then decelerates to a subpar rate as firms lag somewhat in adjusting their labor input to the slower rate of output growth.

**Wages and prices.** We have edged down the projection for core CPI inflation in 1997 to 2.4 percent and trimmed a couple of tenths from the projection for 1998, which now stands at 2.6 percent. In 1999, the core CPI is projected to rise 2.8 percent. The true acceleration in prices is larger than these numbers suggest, as the published figures for 1998 and 1999 will be held down by the technical adjustments to the CPI. But even so, the rise in inflation is smaller than would be generated by applying historical sacrifice ratios to our unemployment projection.

One factor leading us to be more sanguine about the prospects for rising inflation is the apparent absence of price pressures in goods markets. Surely, the dollar's appreciation has been an important part of this story. And, based on our exchange rate path, the prospect is that we shall be losing that favorable influence over the coming quarters. However, the reported lack of pricing "leverage" in manufacturing probably also has been associated with the rapid growth in capacity. In the projection, we have given somewhat more weight to this story, and thus the easing of pressures on capacity over the next two years limits the ability by manufacturers to fully pass their labor cost increases into prices.

In addition, as actual inflation has come down--and stayed down--average inflation expectations among consumers and businessmen increasingly appear to have receded. Moreover, judging by the narrowing variance of price expectations in the Michigan SRC survey, fewer people appear fearful that inflation will get out of hand in the foreseeable future. One may conjecture that this development owes in part to the public's perception that the Fed has both the ability and the commitment to keep inflation in check. This credibility could help to anchor expectations in the period ahead, muting what might otherwise be greater tendencies for inflation to pick up in response to tight markets. However, this would not be a permanent preventive: A persistence of excess demand would ultimately manifest itself in a rise in inflation and inflation expectations. Nevertheless, we view the possibility of a credibility dividend, which presumably would be strengthened by the assumed, largely pre-emptive, policy tightening, as one reason for tempering the wage-price acceleration in this forecast.

Apart from our more optimistic view of core inflation, relative declines in food and energy prices are expected to hold down overall price increases next year. Energy prices are projected to change little in 1998, as deregulation restrains price increases for electricity and gasoline prices drop back from the high levels expected for the second half of this year. In 1999, energy prices rise a little over 2 percent, reflecting the uptrend in oil prices. Food prices are projected to rise about 2-1/4 percent in 1998, as this year's crop harvest seems large enough to result in a moderate





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

Measure	1996	1997	1998	1999
Consumer price index	3.2	2.1	2.3	2.7
Previous	3.2	2.1	2.6	...
Food	4.2	1.8	2.2	2.5
Previous	4.2	1.5	2.4	...
Energy	7.6	-1.5	-.0	2.2
Previous	7.6	-1.6	1.0	...
Excluding food and energy	2.6	2.4	2.6	2.8
Previous	2.6	2.5	2.8	...
PCE chain-weighted price index	2.7	1.7	2.2	2.5
Previous	2.7	1.8	2.3	...
Excluding food and energy	2.4	1.8	2.3	2.5
Previous	2.4	2.0	2.4	...
GDP chain-weighted price index	2.4	1.9	2.1	2.2
Previous	2.4	1.9	2.2	...
ECI for compensation of private industry workers <sup>1</sup>	3.1	3.1	3.2	3.3
Previous	3.1	3.2	3.3	...
Prices of core non-oil merchandise imports	-.7	-.5	0.6	1.9
Previous	-.7	.2	1.5	...
	Percentage points			
MEMO				
Adjustment to the core CPI for technical changes <sup>2</sup>	.2	.2	.4	.6

1. December to December.

2. Adjustments are calculated relative to the methodological structure of the CPI in 1994.

... Not applicable.

accumulation of inventories over the coming year; we have a slight further pickup in 1999 along with faster labor cost growth. Overall, we expect the total CPI to rise 2 percent this year, 2-1/4 percent in 1998, and 2-3/4 percent in 1999.

Our forecast for hourly compensation now shows the ECI for private industry accelerating from 2.9 percent in the twelve months ended this past June to 3.2 percent in 1998. The slightly more modest acceleration of compensation in this projection reflects, in part, the lower forecast for inflation; real compensation gains (measured in

terms of product prices) have been somewhat above trend productivity growth recently, a pattern we expect to continue over the forecast period. In addition, we continue to hear reports that employers are increasingly replacing general wage increases with more flexible pay arrangements--such as bonuses and incentive pay--and targeting pay gains to workers in high demand, which may be altering the historical short-run relationship of aggregate compensation growth to general labor market conditions. The UPS settlement has not materially affected our view of the wage outlook. Although some analysts have pointed to the settlement as signaling an important shift in bargaining power towards workers, a closer look at the details of this contract suggests that the eventual settlement was much more favorable to UPS than was reported in the press.<sup>2</sup>

### Monetary and Credit Flows

Domestic nonfinancial debt is projected to rise about 4-1/2 percent this year and to average slightly more than that over the next two years as well. Federal sector debt is expected to continue increasing in a range of only 1 to 2 percent per year over the forecast period. Debt of state and local governments, which appears to be growing at a 3 percent rate this year, is expected to grow a little faster over the next two years, largely owing to smaller retirements of debt that had been advance-refunded in previous years.

Household debt is projected to slow slightly from the 6 percent growth pace of 1997. Borrowing for home mortgages in the period ahead appears likely to remain around the moderate pace seen so far this year, although home equity lending will likely continue to substitute for other types of loans to households. Consumer credit is expected to grow just a little faster than income. Access to consumer credit is unlikely to be a problem for most households. Delinquency rates on consumer loans, which had risen since late 1994, appear to have leveled off of late, suggesting less inclination on the part of lenders to tighten standards in the months ahead beyond the limited steps taken over the last year or so.

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2. In particular, much of the discussion in the press focused on the sizable wage increases given to part-time workers (about 8 percent per year over five years). As it turns out, however, these increases apply only to currently employed part-time workers. Newly hired workers will receive only a slightly higher starting wage than under the old contract (and then will progress at the same rate as in the previous contract). Because UPS has very high turnover among its part-time workforce, we estimate that the actual increase in the company's wage costs for part-time workers will be closer to 3 percent per year, about the same as the increase for full-time workers.

Business borrowing should expand briskly over the forecast period, as capital spending picks up, profits flatten, and financing conditions stay generally favorable. Merger activity will likely ease somewhat from this year's record pace, but still require substantial amounts of debt financing. A less robust outlook for profits and declining stock prices could damp the current enthusiasm for lower-rated bonds and cause risk spreads to widen. Overall bond issuance is projected to slow only slightly, however, from its unusually strong third-quarter pace. With delinquencies on business loans still at historically low levels, bank lending standards have continued to ease of late, although any further easing might be limited if the softer earnings picture in our projection materializes.

The recent surge in growth in M2, apparently outdistancing that of GDP, likely reflects some temporary substitution away from investment in equity markets, as suggested by the lull in flows into equity mutual funds and surge into money funds following the mid-August plunge in equity prices. M2 growth, projected to be near the upper end of its 1 percent to 5 percent range this year, should slow with the slackening of GDP growth over the next two years. Additional restraint on M2 growth from increases in short-term nominal interest rates in 1998 may be largely offset if the equity market correction anticipated in our forecast prompts some shift toward safer investments. M3 has grown quite rapidly in recent months and appears likely to exceed its 2 percent to 6 percent range by a wide margin this year. The recent surge in M3 owes partly to a substitution by banks of domestic funding for overseas sources and is unlikely to be sustained in the period ahead. However, M3 is expected to continue growing significantly faster than GDP over the next two years, reflecting strength in bank lending and an ongoing penetration by institutional money funds in the liquidity-management market.

### **Alternative Simulations**

The two alternative scenarios that we have included this month depict the implications of differing assumptions regarding the federal funds rate. The first scenario holds the funds rate at its current 5-1/2 percent level through the end of 1999. These lower rates are sufficient to boost GDP growth relative to our baseline forecast about 1/4 percentage point in 1998 and 3/4 percentage point in 1999. Given the faster output growth, the unemployment rate remains below 4-1/2 percent throughout the projection period and the inflationary consequences are more substantial, particularly in 1999.

The second alternative assumes that the funds rate begins to rise soon and reaches 7 percent next summer. In this scenario, output growth falls to about 2 percent in 1998 and to 1-1/4 percent in 1999. This slower rate of output growth pushes the unemployment rate up to 5-1/4 percent by late 1999 and almost eliminates the acceleration in prices, at least as published with the anticipated technical changes.

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

Measure	1996	1997	1998	1999
<i>Real GDP</i>				
Baseline	3.2	3.6	2.3	1.5
No further change	3.2	3.6	2.6	2.2
Tighter policy	3.2	3.6	1.9	1.3
<i>Civilian unemployment rate<sup>1</sup></i>				
Baseline	5.3	4.7	4.5	4.9
No further change	5.3	4.7	4.4	4.4
Tighter policy	5.3	4.7	4.7	5.2
<i>CPI excluding food and energy</i>				
Baseline	2.6	2.5	2.6	2.8
No further change	2.6	2.4	2.7	3.2
Tighter policy	2.6	2.4	2.5	2.5

1. Average for the fourth quarter.

Strictly Confidential <FR>  
Class II FOMC

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

September 24, 1997

Interval	Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index <sup>1</sup>		Unemployment rate <sup>2</sup>		
	08/14/97	09/24/97	08/14/97	09/24/97	08/14/97	09/24/97	08/14/97	09/24/97	08/14/97	09/24/97	
<b>ANNUAL</b>											
1995	4.6	4.6	2.0	2.0	2.5	2.5	2.8	2.8	5.6	5.6	
1996	5.1	5.1	2.8	2.8	2.3	2.3	3.0	3.0	5.4	5.4	
1997	5.5	5.8	3.4	3.7	2.0	2.0	2.4	2.4	5.0	4.9	
1998	4.3	4.8	2.2	2.7	2.0	2.0	2.4	2.2	4.7	4.5	
1999		3.8		1.6		2.2		2.6		4.7	
<b>QUARTERLY</b>											
1996	Q1	4.7	4.7	1.8	1.8	2.8	2.8	3.2	3.2	5.6	5.6
	Q2	7.7	7.7	6.0	6.0	1.9	1.9	3.4	3.4	5.4	5.4
	Q3	3.6	3.6	1.0	1.0	2.7	2.7	2.8	2.8	5.3	5.3
	Q4	6.2	6.2	4.3	4.3	1.9	1.9	3.3	3.3	5.3	5.3
1997	Q1	7.4	7.4	4.9	4.9	2.4	2.4	2.3	2.3	5.3	5.3
	Q2	4.2	5.2	2.6	3.6	1.5	1.6	1.0	1.0	4.9	4.9
	Q3	3.9	4.5	2.2	2.8	1.8	1.5	2.2	2.1	4.8	4.8
	Q4	4.5	5.0	2.4	3.0	2.0	2.0	2.6	2.7	4.7	4.7
1998	Q1	4.4	5.3	2.3	3.0	2.1	2.2	2.4	2.1	4.7	4.6
	Q2	4.4	4.8	2.1	2.6	2.2	2.1	2.5	2.3	4.7	4.5
	Q3	4.1	4.0	1.9	1.9	2.2	2.0	2.7	2.4	4.7	4.5
	Q4	4.0	3.6	1.7	1.5	2.2	2.0	2.7	2.5	4.7	4.5
1999	Q1		3.9		1.5		2.4		2.7		4.6
	Q2		3.6		1.4		2.1		2.8		4.7
	Q3		3.6		1.4		2.1		2.7		4.8
	Q4		3.7		1.5		2.1		2.7		4.9
<b>TWO-QUARTER<sup>3</sup></b>											
1996	Q2	6.2	6.2	3.8	3.8	2.3	2.3	3.4	3.4	-0.2	-0.2
	Q4	4.9	4.9	2.7	2.7	2.3	2.3	3.0	3.0	-0.1	-0.1
1997	Q2	5.8	6.3	3.7	4.3	2.0	2.0	1.7	1.7	-0.4	-0.4
	Q4	4.2	4.8	2.3	2.9	1.9	1.7	2.4	2.4	-0.2	-0.2
1998	Q2	4.4	5.0	2.2	2.8	2.1	2.1	2.5	2.2	-0.0	-0.2
	Q4	4.1	3.8	1.8	1.7	2.2	2.0	2.7	2.5	-0.0	0.0
1999	Q2		3.7		1.4		2.3		2.8		0.2
	Q4		3.6		1.5		2.1		2.7		0.2
<b>FOUR-QUARTER<sup>4</sup></b>											
1995	Q4	4.0	4.0	1.6	1.6	2.4	2.4	2.6	2.6	0.0	0.0
1996	Q4	5.6	5.6	3.2	3.2	2.3	2.3	3.2	3.2	-0.3	-0.3
1997	Q4	5.0	5.5	3.0	3.6	1.9	1.9	2.1	2.1	-0.6	-0.6
1998	Q4	4.2	4.4	2.0	2.3	2.2	2.1	2.6	2.3	-0.1	-0.2
1999	Q4		3.7		1.5		2.2		2.7		0.4

1. For all urban consumers.

2. Level, except as noted.

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

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

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

September 24, 1997

Item	Units <sup>1</sup>	- - - Projected - - -								
		1991	1992	1993	1994	1995	1996	1997	1998	1999
<b>EXPENDITURES</b>										
Nominal GDP	Bill. \$	5916.7	6244.4	6558.1	6947.0	7265.4	7636.0	8079.2	8464.0	8784.3
Real GDP	Bill. Ch. \$	6079.4	6244.4	6389.6	6610.7	6742.1	6928.4	7188.0	7384.1	7501.5
Real GDP	% change	0.4	3.6	2.4	3.3	1.6	3.2	3.6	2.3	1.5
Gross domestic purchases		0.0	4.0	3.0	3.6	1.2	3.6	4.0	2.5	1.6
Final sales		-0.4	3.9	2.1	2.7	2.2	3.1	3.4	2.5	1.6
Priv. dom. final purchases		-0.8	4.9	3.7	3.7	2.5	3.8	4.4	3.2	2.0
Personal cons. expenditures		-0.2	4.2	2.7	3.1	2.2	2.7	3.5	2.8	1.7
Durables		-3.1	9.4	7.4	6.3	3.0	3.9	7.8	4.0	1.4
Nondurables		-1.0	3.4	1.6	3.0	1.0	1.8	1.8	2.7	1.1
Services		0.9	3.6	2.3	2.5	2.7	2.8	3.4	2.6	2.1
Business fixed investment		-6.0	5.5	9.9	7.6	6.5	11.7	12.0	7.9	5.6
Producers' dur. equipment		-2.6	9.6	12.2	10.2	8.3	12.2	16.5	9.6	6.6
Nonres. structures		-12.5	-3.4	4.5	1.1	2.0	10.3	0.9	3.1	2.9
Residential structures		1.1	16.9	7.8	4.2	-1.9	3.9	1.8	-2.6	-2.2
Exports		8.6	4.1	4.6	10.0	10.3	9.3	12.3	7.6	6.1
Imports		4.1	7.4	10.2	12.3	5.6	11.8	14.9	9.2	7.0
Gov't. cons. & investment		-0.7	1.7	-1.4	0.1	-1.4	2.0	0.9	0.7	0.7
Federal		-3.1	1.3	-6.1	-3.9	-6.0	1.5	-1.1	-2.0	-2.2
Defense		-5.3	-1.3	-6.9	-6.0	-5.9	1.1	-3.0	-3.5	-2.7
State & local		1.0	2.0	2.0	2.7	1.4	2.2	2.0	2.3	2.3
Change in bus. inventories	Bill. Ch. \$	-3.0	7.0	22.1	60.6	27.3	25.0	60.7	35.7	28.7
Nonfarm		-1.2	2.0	29.5	49.0	35.7	22.5	54.0	31.5	25.3
Net exports		-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-139.3	-165.1	-194.8
Nominal GDP	% change	3.8	6.3	5.0	5.8	4.0	5.6	5.5	4.4	3.7
<b>EMPLOYMENT AND PRODUCTION</b>										
Nonfarm payroll employment	Millions	108.3	108.6	110.7	114.1	117.2	119.5	122.2	124.7	126.0
Unemployment rate	%	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4.7
Industrial prod. index	% change	-0.0	3.9	3.0	5.7	1.8	3.9	4.8	2.3	1.4
Capacity util. rate - mfg.	%	78.0	79.5	80.8	83.1	83.1	82.1	82.7	82.7	82.0
Housing starts	Millions	1.01	1.20	1.29	1.46	1.35	1.48	1.45	1.41	1.37
Light motor vehicle sales		12.52	12.85	13.87	15.02	14.73	15.05	15.00	14.92	14.54
North Amer. produced		9.74	10.51	11.71	12.88	12.82	13.34	13.09	13.09	12.77
Other		2.77	2.34	2.15	2.13	1.90	1.71	1.91	1.83	1.77
<b>INCOME AND SAVING</b>										
Nominal GNP	Bill. \$	5932.4	6255.5	6576.8	6955.2	7270.6	7637.7	8057.6	8430.6	8744.5
Nominal GNP	% change	3.5	6.2	5.1	5.7	4.1	5.5	5.1	4.3	3.6
Nominal personal income		3.7	7.3	4.2	5.1	5.2	5.8	5.6	4.7	4.1
Real disposable income		0.8	4.0	1.5	2.4	2.4	2.0	3.2	2.7	1.9
Personal saving rate	%	6.0	6.2	5.1	4.2	4.8	4.3	3.8	3.7	3.9
Corp. profits, IVA & CCAdj.	% change	4.5	11.3	19.0	14.1	11.0	9.1	5.6	1.0	-1.1
Profit share of GNP	%	6.9	6.8	7.5	8.2	8.9	9.6	9.8	9.5	9.0
Excluding FR Banks	%	6.6	6.6	7.2	7.9	8.6	9.3	9.5	9.2	8.8
Federal surpl./deficit	Bill. \$	-196.0	-280.9	-250.7	-186.7	-174.4	-110.5	-30.1	-18.4	-36.8
State & local surpl./def.		75.8	86.3	87.4	96.8	103.1	105.3	105.9	112.3	108.5
Ex. social ins. funds		11.5	18.3	19.7	27.9	32.5	34.1	34.4	40.6	36.7
<b>PRICES AND COSTS</b>										
GDP implicit deflator	% change	3.4	2.6	2.6	2.5	2.4	2.2	1.9	2.1	2.2
GDP chn.-wt. price index		3.3	2.6	2.6	2.5	2.4	2.3	1.9	2.1	2.2
Gross Domestic Purchases										
chn.-wt. price index		2.7	2.7	2.3	2.5	2.3	2.3	1.4	1.9	2.2
CPI		3.0	3.1	2.7	2.7	2.6	3.2	2.1	2.3	2.7
Ex. food and energy		4.4	3.5	3.1	2.8	3.0	2.6	2.4	2.6	2.8
ECI, hourly compensation <sup>2</sup>		4.4	3.5	3.6	3.1	2.6	3.1	3.1	3.2	3.3
Nonfarm business sector										
Output per hour		2.2	3.5	-0.2	-0.1	0.4	1.2	1.8	1.0	0.9
Compensation per Hour		4.8	4.5	1.8	1.9	2.8	3.3	3.7	3.5	3.5
Unit labor cost		2.5	1.0	2.0	2.0	2.4	2.1	1.8	2.5	2.6

1. Changes are from fourth quarter to fourth quarter.

2. Private-industry workers.

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

September 24, 1997

Item	Units	1995	1995	1995	1995	1996	1996	1996	1996	1997	1997
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
<b>EXPENDITURES</b>											
Nominal GDP	Bill. \$	7168.9	7209.5	7301.3	7381.9	7467.5	7607.7	7676.0	7792.9	7933.6	8035.4
Real GDP	Bill. Ch. \$	6703.7	6708.8	6759.2	6796.5	6826.4	6926.0	6943.8	7017.4	7101.6	7165.5
Real GDP	% change	0.9	0.3	3.0	2.2	1.8	6.0	1.0	4.3	4.9	3.6
Gross domestic purchases		1.3	0.2	1.9	1.3	3.1	6.5	2.4	2.5	5.9	3.8
Final sales		1.8	1.9	3.3	2.0	2.6	5.2	0.2	4.5	3.0	2.9
Priv. dom. final purchases		2.5	2.2	2.7	2.5	4.4	5.5	2.1	3.2	5.1	3.1
Personal cons. expenditures		1.5	2.9	2.6	1.8	3.1	3.7	0.5	3.3	5.3	1.1
Durables		-3.0	3.9	9.3	2.0	4.8	9.7	-1.9	3.5	14.1	-5.2
Nondurables		1.7	0.9	0.7	0.7	1.7	2.6	0.6	2.1	4.7	-2.1
Services		2.4	3.7	2.2	2.3	3.5	3.1	1.0	3.9	3.9	4.0
Business fixed investment		14.2	5.7	1.6	4.9	11.7	13.0	16.5	5.9	4.1	15.5
Producers' dur. equipment		16.1	6.2	2.0	9.4	13.1	14.9	19.1	2.6	6.7	24.2
Nonres. structures		9.5	4.3	0.7	-5.8	8.2	7.9	10.0	15.3	-2.1	-4.6
Residential structures		-7.0	-15.5	8.4	8.5	8.3	17.9	-4.5	-4.3	3.3	7.5
Exports		7.2	9.3	13.5	11.5	1.7	9.6	1.9	25.5	9.9	20.2
Imports		10.0	7.7	2.3	2.4	13.1	14.1	13.2	6.8	17.9	20.5
Gov't. cons. & investment		0.6	-0.1	-0.7	-5.4	1.8	7.2	-1.1	0.1	-0.4	3.2
Federal		-1.1	-4.5	-1.3	-16.4	7.5	8.8	-4.2	-5.2	-5.8	6.8
Defense		-1.1	-1.6	-4.0	-15.9	6.1	11.0	-4.6	-7.1	-11.8	7.6
State & local		1.7	2.6	-0.4	1.9	-1.4	6.3	0.7	3.3	2.7	1.2
Change in bus. inventories	Bill. Ch. \$	48.5	21.6	17.0	22.2	8.0	21.3	37.9	32.9	63.7	76.7
Nonfarm		54.7	34.0	29.6	24.4	14.5	17.3	31.6	26.5	58.3	69.3
Net exports		-113.5	-112.8	-92.9	-76.1	-100.8	-112.6	-138.9	-105.6	-126.3	-132.9
Nominal GDP	% change	4.2	2.3	5.2	4.5	4.7	7.7	3.6	6.2	7.4	5.2
<b>EMPLOYMENT AND PRODUCTION</b>											
Nonfarm payroll employment	Millions	116.5	116.9	117.4	117.9	118.5	119.2	119.9	120.5	121.1	121.9
Unemployment rate	%	5.5	5.6	5.7	5.6	5.6	5.4	5.3	5.3	5.3	4.9
Industrial prod. index	% change	3.9	-0.7	3.2	0.8	1.6	6.2	3.3	4.5	4.4	4.3
Capacity util. rate - mfg.	%	84.2	83.1	82.9	82.3	81.7	82.1	82.3	82.3	82.5	82.5
Housing starts	Millions	1.32	1.29	1.42	1.41	1.46	1.50	1.49	1.42	1.47	1.46
Light motor vehicle sales		14.67	14.42	14.86	14.96	15.04	15.13	15.08	14.95	15.26	14.51
North Amer. produced		12.66	12.46	13.00	13.18	13.38	13.43	13.38	13.18	13.34	12.67
Other		2.01	1.96	1.86	1.78	1.66	1.70	1.70	1.76	1.92	1.85
<b>INCOME AND SAVING</b>											
Nominal GNP	Bill. \$	7175.1	7220.6	7298.3	7388.5	7475.3	7610.5	7669.1	7796.1	7919.2	8015.1
Nominal GNP	% change	4.5	2.6	4.4	5.0	4.8	7.4	3.1	6.8	6.5	4.9
Nominal personal income		7.4	4.1	4.3	5.1	6.8	6.6	5.1	4.8	8.0	5.0
Real disposable income		4.5	0.2	2.6	2.5	3.5	1.1	2.7	0.7	4.6	2.9
Personal saving rate	%	5.3	4.6	4.5	4.6	4.7	4.1	4.5	3.9	3.7	4.1
Corp. profits, IVA & CCAdj.	% change	-2.9	10.0	31.7	7.9	20.0	12.1	0.6	4.5	18.1	9.1
Profit share of GNP	%	8.5	8.7	9.2	9.3	9.6	9.7	9.6	9.6	9.8	9.9
Excluding FR Banks	%	8.2	8.4	8.9	9.0	9.3	9.4	9.4	9.3	9.6	9.7
Federal surpl./deficit	Bill. \$	-191.5	-179.5	-176.5	-150.2	-153.6	-111.6	-99.5	-77.1	-55.5	-34.7
State & local surpl./def.		107.7	105.6	101.1	97.8	104.1	114.4	102.6	100.4	104.7	105.6
Ex. social ins. funds		37.7	35.3	30.3	26.8	33.2	43.1	31.1	28.9	33.5	34.0
<b>PRICES AND COSTS</b>											
GDP implicit deflator	% change	3.3	2.0	2.1	2.2	2.9	1.7	2.6	1.9	2.4	1.5
GDP chn.-wt. price index		3.3	2.1	2.0	2.1	2.8	1.9	2.7	1.9	2.4	1.6
Gross Domestic Purchases											
chn.-wt. price index		3.0	2.5	1.7	1.9	2.7	1.8	2.4	2.4	1.9	0.9
CPI		2.7	3.5	2.1	2.6	3.2	3.4	2.8	3.3	2.3	1.0
Ex. food and energy		3.3	3.3	2.8	2.7	2.7	2.7	2.4	2.7	2.2	2.9
ECI, hourly compensation <sup>1</sup>		2.9	2.6	2.6	2.9	2.5	3.5	2.8	2.8	2.5	3.4
Nonfarm business sector											
Output per hour		-1.6	0.8	1.1	1.6	1.9	2.2	-1.0	1.8	1.4	2.8
Compensation per hour		2.6	3.1	2.7	2.9	2.8	4.4	2.9	3.3	4.5	3.2
Unit labor cost		4.2	2.3	1.6	1.3	0.9	2.1	3.9	1.5	3.1	0.4

1. Private-industry workers.

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

September 24, 1997

Item	Units	Projected									
		1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4
<b>EXPENDITURES</b>											
Nominal GDP	Bill. \$	8123.9	8224.0	8330.8	8428.3	8510.8	8586.2	8668.3	8744.6	8822.0	8902.2
Real GDP	Bill. Ch. \$	7215.6	7269.2	7323.8	7371.8	7406.3	7434.4	7461.5	7487.8	7514.0	7542.7
Real GDP	% change	2.8	3.0	3.0	2.6	1.9	1.5	1.5	1.4	1.4	1.5
Gross domestic purchases		3.7	2.5	2.9	3.3	2.8	1.2	1.9	1.5	2.0	1.1
Final sales		3.9	3.7	3.7	2.3	1.7	2.2	1.2	1.6	1.3	2.3
Priv. dom. final purchases		5.9	3.7	4.3	3.5	2.8	2.2	2.0	2.0	2.1	2.0
Personal cons. expenditures		4.1	3.4	3.3	3.3	2.8	1.9	1.8	1.7	1.7	1.6
Durables		15.3	8.2	4.7	5.5	3.6	2.2	1.9	0.9	1.0	1.7
Nondurables		2.7	2.1	3.5	3.2	2.6	1.5	1.3	1.1	0.9	0.9
Services		2.7	3.1	2.9	2.9	2.7	2.1	2.1	2.1	2.2	1.9
Business fixed investment		22.9	6.6	12.5	7.1	5.3	6.7	5.8	5.8	5.5	5.2
Producers' dur. equipment		28.8	8.0	16.1	8.6	6.1	8.0	6.8	6.9	6.5	6.1
Nonres. structures		7.9	3.0	3.1	3.1	3.1	3.0	3.0	3.0	2.9	2.9
Residential structures		-4.6	1.3	-0.0	-1.4	-4.0	-4.9	-5.2	-3.3	-0.9	0.7
Exports		4.9	14.7	11.4	6.5	2.4	10.1	3.4	8.2	2.5	10.7
Imports		12.0	9.6	9.7	11.4	9.1	6.7	6.5	8.3	7.0	6.3
Gov't. cons. & investment		-0.1	0.9	0.6	0.4	1.8	0.2	0.2	0.5	1.4	0.7
Federal		-3.4	-1.8	-2.3	-3.1	0.9	-3.6	-3.6	-2.6	-0.3	-2.2
Defense		-3.6	-3.1	-4.4	-5.6	1.0	-4.9	-4.9	-3.4	0.3	-2.7
State & local		1.8	2.4	2.3	2.3	2.3	2.3	2.3	2.2	2.2	2.3
Change in bus. inventories	Bill. Ch. \$	57.4	44.9	32.3	38.7	42.1	29.7	34.0	30.1	32.1	18.5
Nonfarm		49.8	38.5	26.8	34.4	38.6	26.4	30.7	26.7	28.7	15.2
Net exports		-152.9	-145.0	-144.5	-160.2	-180.6	-175.0	-186.0	-190.1	-205.7	-197.4
Nominal GDP	% change	4.5	5.0	5.3	4.8	4.0	3.6	3.9	3.6	3.6	3.7
<b>EMPLOYMENT AND PRODUCTION</b>											
Nonfarm payroll employment	Millions	122.6	123.2	123.9	124.5	124.9	125.3	125.6	125.9	126.1	126.4
Unemployment rate	%	4.8	4.7	4.6	4.5	4.5	4.5	4.6	4.7	4.8	4.9
Industrial prod. index	% change	5.8	4.5	3.5	2.7	1.5	1.6	1.6	1.4	1.2	1.4
Capacity util. rate - mfg.	%	83.0	83.0	83.0	82.9	82.5	82.3	82.2	82.1	82.0	81.9
Housing starts	Millions	1.43	1.43	1.43	1.42	1.40	1.38	1.36	1.36	1.37	1.38
Light motor vehicle sales		15.16	15.05	15.04	14.99	14.88	14.75	14.65	14.55	14.47	14.50
North Amer. produced		13.18	13.17	13.18	13.15	13.06	12.95	12.87	12.78	12.71	12.73
Other		1.98	1.88	1.86	1.84	1.82	1.80	1.78	1.77	1.76	1.77
<b>INCOME AND SAVING</b>											
Nominal GNP	Bill. \$	8100.0	8196.1	8300.3	8396.2	8475.9	8549.9	8631.7	8706.7	8781.0	8858.4
Nominal GNP	% change	4.3	4.8	5.2	4.7	3.9	3.5	3.9	3.5	3.5	3.6
Nominal personal income		4.5	5.2	6.0	4.1	4.6	4.3	4.9	3.7	3.9	4.1
Real disposable income		2.6	2.6	5.3	1.6	2.0	1.8	4.3	0.9	1.1	1.5
Personal saving rate	%	3.8	3.6	4.1	3.7	3.6	3.5	4.1	3.9	3.8	3.8
Corp. profits, IVA & CCAdj.	% change	-3.5	0.1	4.2	4.8	-1.9	-3.0	-1.9	-1.3	-0.2	-0.9
Profit share of GNP	%	9.7	9.6	9.6	9.6	9.5	9.3	9.2	9.1	9.0	8.9
Excluding FR Banks	%	9.5	9.4	9.4	9.4	9.2	9.1	8.9	8.8	8.8	8.7
Federal surpl./deficit	Bill. \$	-13.5	-16.7	-27.8	-15.7	-11.5	-18.5	-40.7	-36.1	-32.0	-38.4
State & local surpl./def.		101.2	111.9	112.8	113.5	111.5	111.3	110.4	108.9	107.8	107.1
Ex. social ins. funds		29.6	40.3	41.2	41.8	39.8	39.6	38.6	37.1	36.0	35.3
<b>PRICES AND COSTS</b>											
GDP implicit deflator	% change	1.6	2.0	2.2	2.1	2.0	2.0	2.4	2.1	2.1	2.1
GDP chn.-wt. price index		1.5	2.0	2.2	2.1	2.0	2.0	2.4	2.1	2.1	2.1
Gross Domestic Purchases											
chn.-wt. price index		1.2	1.7	2.0	1.9	1.9	2.0	2.4	2.1	2.1	2.1
CPI		2.1	2.7	2.1	2.3	2.4	2.5	2.7	2.8	2.7	2.7
Ex. food and energy		1.9	2.8	2.5	2.5	2.6	2.6	2.8	2.8	2.8	2.8
ECI, hourly compensation <sup>1</sup>		3.2	3.4	2.7	3.4	3.5	3.4	2.9	3.4	3.5	3.5
Nonfarm business sector											
Output per hour		1.5	1.4	1.6	1.4	0.7	0.5	0.6	0.9	1.2	1.1
Compensation per hour		3.2	3.6	3.5	3.5	3.5	3.5	3.5	3.5	3.6	3.6
Unit labor cost		1.7	2.2	2.0	2.2	2.8	3.0	2.9	2.6	2.3	2.5

1. Private-industry workers.



Item	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	96Q4/ 95Q4	97Q4/ 96Q4	98Q4/ 97Q4
Real GDP	4.3	4.9	3.6	2.8	3.0	3.0	2.6	1.9	1.5	3.2	3.6	2.3
Gross dom. purchases	2.5	6.0	3.8	3.8	2.6	3.0	3.3	2.8	1.2	3.6	4.0	2.6
Final sales	4.5	3.0	2.8	3.9	3.7	3.7	2.3	1.7	2.2	3.1	3.4	2.5
Priv. dom. final purchases	2.7	4.2	2.5	4.9	3.1	3.5	2.9	2.3	1.8	3.1	3.7	2.6
Personal cons. expenditures	2.2	3.6	0.7	2.8	2.3	2.2	2.2	1.9	1.3	1.8	2.4	1.9
Durables	0.3	1.1	-0.4	1.2	0.6	0.4	0.4	0.3	0.2	0.3	0.6	0.3
Nondurables	0.4	0.9	-0.4	0.5	0.4	0.7	0.6	0.5	0.3	0.4	0.4	0.5
Services	1.5	1.5	1.6	1.1	1.2	1.1	1.1	1.1	0.8	1.1	1.4	1.1
Business fixed investment	0.6	0.4	1.5	2.2	0.7	1.3	0.8	0.6	0.7	1.1	1.2	0.8
Producers' dur. equip.	0.2	0.5	1.6	2.0	0.6	1.2	0.7	0.5	0.6	0.9	1.2	0.7
Nonres. structures	0.4	-0.1	-0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.3	0.0	0.1
Residential structures	-0.2	0.1	0.3	-0.2	0.1	-0.0	-0.1	-0.2	-0.2	0.2	0.1	-0.1
Net exports	1.8	-1.0	-0.3	-0.9	0.4	0.1	-0.7	-0.9	0.3	-0.4	-0.4	-0.3
Exports	2.7	1.1	2.2	0.6	1.7	1.3	0.8	0.3	1.2	1.0	1.4	0.9
Imports	-0.8	-2.1	-2.4	-1.5	-1.2	-1.2	-1.4	-1.2	-0.9	-1.4	-1.8	-1.2
Government cons. & invest.	0.0	-0.1	0.6	-0.0	0.2	0.1	0.1	0.3	0.0	0.4	.2	0.1
Federal	-0.4	-0.4	0.4	-0.2	-0.1	-0.1	-0.2	0.1	-0.2	0.1	-0.1	-0.1
Defense	-0.3	-0.6	0.3	-0.2	-0.1	-0.2	-0.2	0.0	-0.2	0.0	-0.1	-0.1
Nondefense	0.0	0.2	0.1	-0.1	0.0	0.0	0.0	0.0	-0.0	0.1	0.1	0.0
State and local	0.4	0.3	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.3
Change in bus. inventories	-0.2	1.8	0.7	-1.0	-0.7	-0.7	0.3	0.2	-0.6	0.1	0.2	-0.2
Nonfarm	-0.2	1.8	0.6	-1.0	-0.6	-0.6	0.4	0.2	-0.6	0.0	0.2	-0.2
Farm	-0.1	0.0	0.1	0.0	-0.1	-0.0	-0.1	-0.0	-0.0	0.1	-0.0	-0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

September 24, 1997

Item	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	97Q4/ 96Q4	98Q4/ 97Q4	99Q4/ 98Q4
Real GDP	3.0	3.0	2.6	1.9	1.5	1.5	1.4	1.4	1.5	3.6	2.3	1.5
Gross dom. purchases	2.6	3.0	3.3	2.8	1.2	1.9	1.5	2.1	1.1	4.0	2.6	1.7
Final sales	3.7	3.7	2.3	1.7	2.2	1.2	1.6	1.3	2.2	3.4	2.5	1.6
Priv. dom. final purchases	3.1	3.5	2.9	2.3	1.8	1.7	1.6	1.7	1.7	3.7	2.6	1.7
Personal cons. expenditures	2.3	2.2	2.2	1.9	1.3	1.3	1.1	1.1	1.1	2.4	1.9	1.2
Durables	0.6	0.4	0.4	0.3	0.2	0.2	0.1	0.1	0.1	0.6	0.3	0.1
Nondurables	0.4	0.7	0.6	0.5	0.3	0.3	0.2	0.2	0.2	0.4	0.5	0.2
Services	1.2	1.1	1.1	1.1	0.8	0.8	0.8	0.9	0.8	1.4	1.1	0.8
Business fixed investment	0.7	1.3	0.8	0.6	0.7	0.6	0.6	0.6	0.6	1.2	0.8	0.6
Producers' dur. equip.	0.6	1.2	0.7	0.5	0.6	0.5	0.5	0.5	0.5	1.2	0.7	0.5
Nonres. structures	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.1	0.1
Residential structures	0.1	-0.0	-0.1	-0.2	-0.2	-0.2	-0.1	-0.0	0.0	0.1	-0.1	-0.1
Net exports	0.4	0.1	-0.7	-0.9	0.3	-0.5	-0.1	-0.6	0.4	-0.4	-0.3	-0.2
Exports	1.7	1.3	0.8	0.3	1.2	0.4	1.0	0.3	1.3	1.4	0.9	0.8
Imports	-1.2	-1.2	-1.4	-1.2	-0.9	-0.9	-1.1	-1.0	-0.9	-1.8	-1.2	-1.0
Government cons. & invest.	0.2	0.1	0.1	0.3	0.0	0.0	0.1	0.2	0.1	0.2	0.1	0.1
Federal	-0.1	-0.1	-0.2	0.1	-0.2	-0.2	-0.2	-0.0	-0.1	-0.1	-0.1	-0.1
Defense	-0.1	-0.2	-0.2	0.0	-0.2	-0.2	-0.1	0.0	-0.1	-0.1	-0.1	-0.1
Nondefense	0.0	0.0	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0	0.1	0.0	-0.0
State and local	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.3	0.3
Change in bus. inventories	-0.7	-0.7	0.3	0.2	-0.6	0.2	-0.2	0.1	-0.7	0.2	-0.2	-0.1
Nonfarm	-0.6	-0.6	0.4	0.2	-0.6	0.2	-0.2	0.1	-0.7	0.2	-0.2	-0.1
Farm	-0.1	-0.0	-0.1	-0.0	-0.0	0.0	0.0	0.0	0.0	-0.0	-0.0	0.0

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

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

September 24, 1997

Item	Fiscal year <sup>5</sup>				1997				1998				1999			
	1996 <sup>a</sup>	1997	1998	1999	Q1 <sup>a</sup>	Q2 <sup>b</sup>	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>UNIFIED BUDGET</b>																
Not seasonally adjusted																
Receipts <sup>1</sup>	1453	1578	1636	1697	349	496	386	362	368	508	397	387	370	520	420	387
Outlays <sup>1</sup>	1560	1606	1687	1747	401	396	403	429	419	421	419	474	404	434	435	454
Surplus/deficit <sup>1</sup>	-107	-28	-51	-50	-52	100	-17	-67	-51	88	-22	-87	-34	86	-15	-67
On-budget	-174	-105	-133	-146	-69	61	-21	-78	-65	42	-32	-104	-50	34	-27	-84
Off-budget	67	76	82	96	17	39	4	12	14	46	10	17	16	51	13	16
Surplus excluding deposit insurance <sup>2</sup>	-116	-43	-56	-53	-56	97	-19	-68	-52	87	-23	-88	-35	85	-15	-68
Means of financing																
Borrowing	130	36	67	63	48	-69	9	56	42	-69	37	64	37	-67	28	51
Cash decrease	-6	17	-13	0	-1	-18	24	-3	11	-15	-5	10	10	-15	-5	10
Other <sup>3</sup>	-16	-25	-2	-13	5	-13	-16	14	-2	-4	-10	13	-13	-4	-9	6
Cash operating balance, end of period	44	27	40	40	33	51	27	31	20	35	40	30	20	35	40	30
<b>NIPA FEDERAL SECTOR</b>																
Seasonally adjusted annual rate																
Receipts	1550	1691	1776	1819	1675	1712	1734	1758	1751	1783	1800	1813	1806	1820	1835	1848
Expenditures	1679	1736	1794	1850	1731	1747	1748	1775	1789	1798	1812	1831	1847	1856	1867	1887
Consumption expend.	447	459	465	469	458	464	461	461	466	465	468	467	470	470	471	471
Defense	302	308	307	307	306	311	308	307	309	306	308	306	307	306	308	307
Nondefense	145	151	158	163	152	153	153	154	158	160	161	161	163	163	164	164
Other expenditures	1232	1277	1328	1381	1273	1283	1286	1313	1323	1333	1344	1364	1377	1386	1396	1416
Current account surplus	-129	-45	-18	-32	-55	-35	-14	-17	-28	-16	-12	-19	-41	-36	-32	-38
Gross investment	69	62	62	60	58	62	63	62	62	61	62	61	60	60	60	60
Current and capital account surplus	-197	-107	-80	-92	-114	-97	-76	-79	-90	-77	-73	-79	-101	-96	-92	-98
<b>FISCAL INDICATORS<sup>4</sup></b>																
High-employment (HEB) surplus/deficit	-223	-177	-189	-199	-178	-177	-166	-178	-197	-190	-189	-194	-210	-200	-192	-193
Change in HEB, percent of potential GDP	-.6	-.6	.1	.1	-.1	0	-.1	.2	.2	-.1	0	.1	.2	-.1	-.1	0
Fiscal impetus (FI), percent, cal. year	-2.3	-2.2	-1.5	-1.9	-1.1	1.6	-1	-.8	.4	-1	.1	-2	1	-1	-.4	-1.3

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1. OMB's September 1997 deficit estimates (assuming the enactment of the President's proposals) are \$37 billion in FY97, \$58 billion in FY98 and \$57 billion in FY99. CBO's September 1997 baseline deficit estimates are \$34 billion in FY97, \$57 billion in FY98 and \$52 billion in FY99. 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 September 1997 deficit estimates (assuming the enactment of the President's proposals), excluding deposit insurance spending, are \$51 billion in FY97, \$63 billion in FY98 and \$59 billion in FY99. CBO's September 1997 baseline deficit estimates, excluding deposit insurance, are \$48 billion in FY97, \$61 billion in FY98 and \$56 billion in FY99.

3. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.

4. HEB is the NIPA current and capital account surplus in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output generated by 2.0 percent real (chain-weighted) growth (2.1 and 2.2 percent in 1998 and 1999, respectively, to reflect CPI modifications) and an associated unemployment rate of 6 percent. Quarterly figures for change in HEB and FI are not at annual rates. Change in HEB, as a percent of nominal potential GDP, is reversed in sign. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (1992) dollars, scaled by real federal consumption plus investment. For change in HEB and FI, negative values indicate restraint.

5. Fiscal year data for the unified budget come from OMB; quarterly data come from the Monthly Treasury Statement and may not sum to OMB fiscal year totals.

a--Actual.  
b--Preliminary.

Strictly Confidential Class II FOMC  
September 24, 1997

Change in Debt of the Domestic Nonfinancial Sectors  
(Percent)

Period <sup>1</sup>	Total <sup>2</sup>	Federal government <sup>3</sup>	Nonfederal						Memo: Nominal GDP
			Total <sup>4</sup>	Households			Business	State and local governments	
				Total	Home mortgages	Consumer credit			
<i>Year</i>									
1987	9.2	8.0	9.6	12.0	15.9	5.1	6.9	12.1	7.4
1988	8.9	8.0	9.2	9.5	10.7	8.6	9.8	6.5	7.6
1989	7.6	7.0	7.8	8.5	9.9	6.0	7.7	5.7	6.4
1990	6.5	11.0	5.3	7.5	9.6	1.9	3.3	5.1	4.4
1991	4.3	11.1	2.3	4.9	6.6	-1.7	-1.8	8.4	3.8
1992	4.8	10.9	2.8	5.1	6.0	0.5	0.6	2.0	6.3
1993	5.2	8.3	4.1	6.2	5.3	7.7	1.5	5.7	5.0
1994	4.8	4.7	4.8	8.2	6.4	14.5	3.7	-4.0	5.8
1995	5.3	4.1	5.8	7.8	6.0	14.2	6.2	-3.8	4.0
1996	5.2	4.0	5.6	7.4	7.9	7.6	4.7	1.2	5.6
1997	4.6	1.2	5.8	6.0	6.4	5.6	6.1	3.1	5.5
1998	5.0	1.9	6.0	5.6	6.2	5.3	6.9	4.0	4.4
1999	4.6	1.3	5.7	5.4	5.8	5.1	6.6	3.8	3.7
<i>Quarter</i>									
1997:1	4.7	2.1	5.6	6.4	6.5	7.1	5.3	3.2	7.4
2	3.7	-2.6	5.9	5.5	5.4	4.2	6.0	7.7	5.2
3	4.3	0.9	5.4	5.9	6.6	5.4	6.3	-0.5	4.5
4	5.3	4.2	5.6	5.8	6.5	5.3	6.3	2.0	5.0
1998:1	4.7	1.4	5.8	5.6	6.2	5.2	6.6	3.3	5.3
2	4.1	-2.2	6.2	5.5	6.1	5.2	6.6	7.6	4.8
3	5.3	3.7	5.8	5.5	5.9	5.2	6.8	3.5	4.0
4	5.5	4.8	5.7	5.4	5.9	5.2	7.0	1.4	3.6

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 1997:Q2 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2. On a monthly average basis, total debt grew 4.4 percent in 1997, 5.0 percent in 1998, and 4.7 percent in 1999.

3. On a monthly average basis, federal debt rose 1.0 percent in 1997, 1.9 percent in 1998, and 1.5 percent in 1999.

4. On a monthly average basis, nonfederal debt increased 5.6 percent in 1997, 6.0 percent in 1998, and 5.8 percent in 1999.

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

Category	Calendar year				Seasonally adjusted annual rates							
					1997				1998			
	1996	1997	1998	1999	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<i>Net funds raised by domestic nonfinancial sectors</i>												
1 Total	651.1	570.2	669.8	681.1	600.0	461.1	556.7	663.2	623.8	538.0	733.0	784.5
2 Net equity issuance	-64.2	-91.9	-85.0	-58.0	-86.2	-83.6	-72.8	-124.8	-82.0	-90.0	-90.0	-78.0
3 Net debt issuance	715.3	662.1	754.8	739.1	686.2	544.7	629.5	788.0	705.8	628.0	823.0	862.5
<i>Borrowing sectors</i>												
<i>Nonfinancial business</i>												
4 Financing gap <sup>1</sup>	8.4	69.6	109.7	151.6	36.1	82.2	79.6	80.5	95.8	103.1	117.4	122.4
5 Net equity issuance	-64.2	-91.9	-85.0	-58.0	-86.2	-83.6	-72.8	-124.8	-82.0	-90.0	-90.0	-78.0
6 Credit market borrowing	193.9	268.9	322.7	328.7	234.5	266.4	284.9	289.6	306.0	314.5	326.4	343.9
<i>Households</i>												
7 Net borrowing <sup>2</sup>	363.8	315.1	313.4	315.6	335.5	291.1	316.3	317.7	311.2	312.3	314.3	316.0
8 Home mortgages	263.9	229.7	235.8	235.4	233.0	195.9	244.0	245.8	237.4	235.9	234.3	235.4
9 Consumer credit	86.3	68.2	68.3	69.3	85.9	52.4	66.9	67.6	67.1	67.9	68.7	69.5
10 Debt/DPI (percent) <sup>3</sup>	90.5	91.9	92.6	93.4	91.3	91.8	92.2	92.4	92.0	92.5	92.8	93.1
<i>State and local governments</i>												
11 Net borrowing	12.7	33.9	44.6	44.6	35.0	84.2	-5.8	22.3	36.5	85.3	40.0	16.6
12 Current surplus <sup>4</sup>	126.1	121.0	123.2	118.9	115.8	124.1	119.0	125.3	124.0	124.6	122.4	122.0
<i>Federal government</i>												
13 Net borrowing	145.0	44.2	74.1	50.2	81.2	-97.1	34.1	158.5	52.2	-84.0	142.3	186.1
14 Net borrowing (quarterly, n.s.a.)	145.0	44.2	74.1	50.2	48.0	-69.2	8.9	56.4	42.5	-69.2	36.8	64.0
15 Unified deficit (quarterly, n.s.a.)	110.9	35.9	71.8	30.3	52.0	-100.1	17.3	66.6	50.8	-87.8	21.8	87.0
<i>Depository institutions</i>												
16 Funds supplied	233.2	280.8	287.8	299.5	330.6	370.2	178.4	244.2	268.0	290.0	288.8	304.4
<i>Memo (percentage of GDP)</i>												
17 Domestic nonfinancial debt <sup>5</sup>	185.2	183.6	183.6	185.4	183.9	183.5	183.3	183.2	183.1	182.9	183.3	184.1
18 Domestic nonfinancial borrowing	9.4	8.2	8.9	8.4	8.6	6.8	7.7	9.6	8.5	7.5	9.7	10.0
19 Federal government <sup>6</sup>	1.9	0.5	0.9	0.6	1.0	-1.2	0.4	1.9	0.6	-1.0	1.7	2.2
20 Nonfederal	7.5	7.6	8.0	7.8	7.6	8.0	7.3	7.7	7.8	8.4	8.0	7.9

Note. Data after 1997:Q2 are staff projections.

1. For corporations: Excess of capital expenditures over U.S. internal funds.

2. Includes change in liabilities not shown in lines 8 and 9.

3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.

4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.

5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.

6. Excludes government-insured mortgage pool securities.

## International Developments

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### Recent Developments

Since the day before the August FOMC meeting, the foreign exchange value of the dollar has depreciated in terms of the mark and other European currencies but has appreciated in terms of the yen. The dollar has appreciated as well in terms of several southeast Asian currencies. On balance, the multilateral-trade weighted-average dollar has declined nearly 2 percent in terms of the other G-10 currencies and in terms of the currencies of a broader group of countries including our major developing-country trading partners.

The dollar has declined about 2-3/4 percent against the mark over the intermeeting period as the perceived likelihood of a tightening of Bundesbank policy in the near term has risen. Stronger real economic activity in Germany and some evidence of rising inflation underlie these heightened expectations of Bundesbank tightening. In addition, it is widely believed that any Bundesbank move will come before the announcement next May of which countries will be participating in Stage Three of EMU and that any further moves from then until the European Central Bank assumes responsibility for monetary policy on January 1, 1999, are unlikely.

The dollar has appreciated about 1-1/2 percent in terms of the yen since the August meeting. Data showing weaker-than-expected Japanese real economic activity in the second quarter and some signs of continued sluggishness in this quarter contributed to downward pressure on the yen. Some spillover effects from substantial depreciations of several southeast Asian currencies may also have been a factor.

On average, short-term market interest rates in the major foreign industrial countries changed little over the intermeeting period. Despite considerable market commentary about the prospects for an increase soon in official Bundesbank rates, German short-term market rates did not change. Average ten-year bond yields moved down 20 basis points abroad. The largest declines occurred in Italy, which benefited from favorable budget developments and renewed confidence in the outlook for its participation in EMU, and the United Kingdom, where previous policy tightening seems to be having an effect.

The dollar moved up slightly against the Mexican peso over the intermeeting period. While Mexican inflation continued to outpace that of its trading partners and the real exchange value of the peso appreciated, indications of continued robust growth, along with trend decline in inflation, buoyed investor interest and supported the peso. The Thai baht, Malaysian ringgit, and Philippine peso depreciated an additional 7 to 10 percent against the dollar.

Since the August FOMC meeting, European stock prices have moved up, but to varying degrees. German stock prices have increased only marginally whereas Italian stock prices are up more than 12 percent and U.K. prices have risen nearly 5 percent. In Japan, stock prices declined an additional 4-1/2 percent on balance over the period. Stock prices in several southeast Asian countries, including Malaysia, Indonesia, and the Philippines, fell further in late August and early September and have been volatile since then.

. The Desk did not intervene.

Expansion of real economic activity continues to be robust in all the major foreign industrial countries except Japan. In Germany, second-quarter real GDP grew at an annual rate of 4.1 percent, led by exports and personal consumption. In July, industrial production and manufacturing orders rose further, and according to the IFO survey, the business climate improved sharply. In the United Kingdom, real GDP expanded at an annual rate of 4.0 percent in the second quarter; consumption and investment expenditures were particularly strong. Industrial production through July and retail sales through August were higher as well. U.K. export orders declined in July and August, and survey data suggest that growth in manufacturing industries is slowing, partly in response to recent monetary tightening and the strength of the pound. Canadian real GDP grew at an annual rate of 4.9 percent in the second quarter, led by growth of total domestic demand of nearly 7-1/2 percent. Employment expanded further through August, but the unemployment rate remained at 9.0 percent because the labor force grew rapidly. In Japan, real GDP declined in the second quarter at an annual rate of 11.2 percent. As expected, consumption fell sharply, more than reversing its first-quarter burst that preceded the increase in the consumption tax. Private investment also fell. In contrast, exports grew vigorously. Some improvement is suggested by a rebound in industrial production and continued strength in machinery orders in July; however, housing starts declined further that month, and new car registrations through August were down. Problems remain in the financial sector.

Consumer price inflation remains low in the major foreign industrial countries. German inflation moved above 2 percent in August for the first time in more than two years; partial data suggest that inflation edged back down in September. U.K. inflation declined slightly in August from the July rate; but at 2.8 percent, it remained above the government's target of 2-1/2 percent.

Financial markets have remained volatile in many of the southeast Asian economies. Although indicators of second-quarter real economic activity in those countries and some partial data for July show generally steady growth, negative implications of the financial turmoil for their real growth may become evident in later data. Elsewhere in Asia, Korean real GDP growth was robust through the second quarter, and industrial production expanded further in July; but several corporate bankruptcies raised concerns, including about the health of the financial sector. Real output growth in Taiwan appears to have slowed in the second quarter, in part the result of transitory weather and agricultural problems but also because of a slowing of export growth. Real economic activity continues to expand briskly in Singapore, Hong Kong, and China.

Real economic activity is also growing strongly in the major Latin American countries. In Mexico and Argentina, real GDP through the second quarter and industrial production through July show continued strong growth. In Brazil, real GDP rebounded sharply in the second quarter from a first-quarter decline.

The nominal U.S. deficit in trade of goods and services widened in July from its second-quarter average. Exports declined about 3/4 percent from the second quarter, led by decreases in aircraft and consumer goods. Imports rose 1 percent from the second quarter, with the largest increases in capital goods and automotive products. In the second quarter, the sharp gain in exports had exceeded the rise of imports, resulting in a narrowing of the nominal trade deficit. The improvement in the trade balance offset further deterioration of net investment income, and the current account deficit narrowed somewhat in the second quarter. The quantity of imported oil rose in the second quarter in response to increased consumption and continued strong in July and (preliminary) August.

Prices of nonagricultural exports rose slightly on average in July and August whereas the prices of agricultural exports dropped sharply. The prices of non-oil imports declined on average in July and August, but at a rate somewhat diminished from the rates recorded in the previous two quarters. The price of imported oil rose 2.2 percent in August. Delays in deliveries of Iraqi oil and disruptions of shipments from Colombia contributed to the slight increase. Oil import prices have changed little on balance since April. The price of spot WTI rose \$0.30 in August to average \$19.93 per barrel. WTI has been trading in the \$19-\$20 per barrel range during September.



## Outlook

In extending the forecast through 1999, we needed to take account explicitly of the scheduled start of Stage Three of European Monetary Union on January 1, 1999. We have assumed that EMU will go forward as planned with eleven countries as initial members.<sup>1</sup> Accordingly, our projection for dollar exchange rates in 1999 incorporates the assumption that after January 1, 1999, bilateral rates among the currencies of these countries will be fixed and short-term market interest rates will be identical in these currencies. In reporting our outlook for activity and prices abroad, we have added aggregates for the EU-11.

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

Measure	1997			1998	1999
	H1	Q3	Q4		
Foreign output	3.8	4.0	4.1	3.9	3.7
Previous	3.7	4.1	4.1	3.9	--
Real exports	14.9	4.9	14.7	7.6	6.1
Previous	11.9	2.3	8.9	4.4	--
Real imports	19.2	12.0	9.6	9.2	7.0
Previous	18.9	5.4	6.3	7.2	--

The staff projects that total foreign real output (weighted by U.S. bilateral export shares) will increase at an annual rate of about 4 percent over the final two quarters of this year and will decelerate slightly through 1999. We continue to expect that the dollar will depreciate moderately from recent levels, but not until late in the forecast period, reflecting the tightening of U.S. monetary conditions during 1998. Although projected growth for U.S. real output is somewhat below that for foreign real output, we project that growth of real imports will exceed that of real exports over the forecast period; historical experience indicates that U.S. imports are more responsive to U.S. income growth than are U.S. exports to growth abroad. As a consequence, real net exports will subtract about 1/3 percentage point from annual real GDP growth throughout the forecast period. Upward revision to the forecast path for U.S. real GDP growth since the August Greenbook raises our projected growth of real imports. Continued strong export performance has led us to revise up our forecast for real

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1. Those countries are Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain.

export growth as well. As a result, the projected contribution of net exports to real GDP growth is about the same as in the August Greenbook.

**The dollar.** We have adjusted the path of the dollar relative to that in the August Greenbook to reflect recent exchange rate changes and the changed assumption about U.S. monetary policy. We continue to expect that the weighted-average value of the dollar will decline at some point during the forecast period as widening U.S. current account deficits depress the dollar, particularly against the yen. Although we remain agnostic as to the timing and degree of dollar adjustment, we believe that a tightening of U.S. policy during 1998 will counter incipient downward pressure on the dollar and so have forecast that the weighted-average dollar in terms of the other G-10 countries remains unchanged through the end of next year. The dollar is projected to depreciate moderately during 1999 as market recognition of the growing U.S. external imbalance is assumed to show through at some point. We expect that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will rise in the fourth quarter of this year but decline thereafter as currency turmoil in those countries subsides.

**Foreign G-7 countries.** Real GDP growth in the foreign G-7 countries (weighted by U.S. bilateral export shares) is projected to average 3-1/4 percent at an annual rate during the second half of this year and then to slow to 2-3/4 percent next year and 2-1/2 percent in 1999. In Japan, real GDP should rebound this quarter from its second-quarter decline as domestic demand improves. Over the second half of this year, real output growth is projected to average about 3 percent at an annual rate; during 1998, growth is projected at 2-1/2 percent. Although the positive contribution of net exports is expected to continue, it should lessen over the forecast period while domestic demand will strengthen moderately. Similarly, in Germany, the boost to GDP growth from net exports is projected to abate somewhat over the forecast period while domestic demand will gradually strengthen. Output growth should slow from its rapid second-quarter pace to an annual rate of 3 percent over the rest of this year and then should average about 2-3/4 percent next year.<sup>2</sup> In the United Kingdom, domestic demand is expected to decelerate in response to past and prospective monetary and fiscal tightening as well as some lessening of the effect of this year's windfall gains to depositors of some financial institutions. These developments should slow U.K. real GDP growth to 2 percent next year from 2-3/4 percent during the remainder of this

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2. For the EU-11 region as a whole, real GDP growth is projected to average about 2-3/4 percent at an annual rate over the remainder of this year and during 1998 (weighted by GDP). Some strengthening is projected on average in 1999.

year. In Canada, growth of private consumption and investment spending are both projected to slow some from their recent rapid pace over the forecast period as monetary policy tightens. Nevertheless, domestic demand growth should remain robust while net exports continue to make a negative contribution; real output growth moves from 3-1/2 percent during the remainder of this year to a bit less than that next year.

Consumer price inflation is projected to remain low over the forecast period in the foreign G-7 countries. U.K. inflation is expected to benefit in the next few quarters from the effects of recent strength in sterling but to rise somewhat over 1998 as the tightness in domestic markets shows through. Inflation in Japan is projected to drop back to less than 1 percent per year once the anniversary of the April 1 tax hike has passed; as a consequence, average inflation in the G-7 countries (weighted by U.S. bilateral import shares) should move down to about 1-1/2 percent in 1998.

Our assumptions about interest rates in several countries reflect the timetable for EMU and our perception of the constraints that schedule will place upon the central banks involved. We expect that additional tightening in Europe led by the Bundesbank will move up short-term market interest rates by the end of this year. Rates in the other EU-11 countries are assumed to converge to German rates by the end of 1998. We have incorporated into the forecast an assumption that the European Central Bank will tighten somewhat during 1999 as the European expansion matures, leading to a rise in market rates. We also expect some further tightening by the Bank of England by the end of this year but have postponed until late 1998 and 1999 the assumed tightening by the Bank of Japan. Long-term market interest rates abroad are assumed to move up gradually over the forecast period as slack in these economies is reduced.

**Other countries.** Real GDP in our major developing-country trading partners is projected to increase at an average annual rate of about 5-1/2 percent (weighted by U.S. bilateral export shares) during the second half of this year, a slight downward revision from August. For countries in Latin America, this revision reflects some offset we expect to very strong second-quarter growth figures, and we have raised our figure for 1997 as a whole. For countries in Asia, an offset to strong second-quarter growth is a factor in some cases, for example, Singapore; but for several southeast Asian countries, we have lowered the forecast in response to the turbulence in their financial markets and to announced government policies. In 1998-99, annual real output growth in developing countries is expected to average 5-3/4 percent.

Mexican real GDP growth is projected to remain robust, with some slowing from the very rapid rate recorded for the first half of this year. Growth should average 4-3/4 percent this year and next. In Argentina, stronger-than-expected growth in the first half of this year has led us to project growth at an annual rate of 6 percent for the remainder of this year and for 1998. In Brazil, we expect substantial slowing from the unsustainably high growth in the second quarter and then real output growth of 3 percent during 1998. We continue to highlight the downside risk to our forecast for Brazil posed by real appreciation of its currency and large current account and fiscal deficits. A downturn in Brazil could exert significant spillover effects on Argentina.

Our outlooks for the Philippines, Malaysia, and especially Thailand have been revised downward as a result of the expected adverse effects on domestic demand of higher interest rates, volatility in financial markets, and deterioration of asset quality.<sup>3</sup> Apparent strength in Singapore and Hong Kong is expected to continue over the forecast period and will largely offset these downward revisions. On average, real output in our Asian developing-country trading partners is projected to grow at an annual rate of 6-1/2 percent over the remainder of this year and during next year, slightly lower than the August Greenbook forecast. We have lowered our forecast for annual growth in Korea as well, to 7 percent for the second half of this year and 6-1/4 percent next year, as the effects of corporate bankruptcies and related scandals are expected to weaken domestic demand.

**U.S. real exports and imports.** In constructing the forecast for real exports of goods and services, we questioned whether the factors that underlay the very rapid growth of real exports over recent quarters signaled a change in the relationship between export volumes and their fundamental determinants. In doing so, we tried to determine the extent to which those factors would continue or reverse. Available evidence is not yet sufficient for us to come to unambiguous answers to these questions. In this forecast we have raised the growth rate of real nonagricultural exports other than computers and semiconductors (core exports) from that in the August Greenbook, carrying forward, but to a declining extent, an unexplained increment to export growth. Core exports are projected to grow at an average annual rate of 8 percent over the second half of this year and to slow to 5-1/4 percent in 1998 and 1-1/2 percent in 1999. The slowdown in core exports results from the lagged

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3. The downward revisions to our forecast for growth in Thailand, 3-1/4 percentage points for 1997 and 3 percentage points for 1998, are large. However, because Thailand has a very small share in U.S. bilateral exports, these revisions imply little change to our forecast for average growth in the region.

effects of dollar appreciation since 1995 and our assumption, noted above, that the special factors boosting export growth will diminish over time. When the forecast for core export growth is combined with that of continued rapid growth in the volumes of computers and semiconductors and moderate growth of services, real exports of total goods and services is projected to grow at an annual rate of 9-1/2 percent over the second half of this year and to slow to 7-1/2 percent in 1998 and 6 percent in 1999.

Our forecast for growth of real non-oil imports other than computers and semiconductors (core imports) has also been increased since the August Greenbook. Core imports are projected to grow at an annual rate of 9-1/2 percent in the second half of this year, slowing to 6-3/4 percent in 1998 and 3-3/4 percent in 1999. In the near term, the upward revision to growth of core imports results from the stronger path for U.S. GDP. In 1998, the higher path for the dollar contributes to the upward revision of core imports as well. Over the forecast period, the projected slowing of U.S. output growth and projected dollar depreciation contribute to the deceleration of core imports. Imports of computers and of semiconductors are again projected to continue to grow rapidly. We expect the quantity of oil imports to decline from the surprisingly high second-quarter rate during the latter half of this year and then to rise during the remainder of the forecast period in line with increases in consumption. We are now projecting U.S. oil production to remain flat, rather than to decline, because of our expectations of increased production from offshore fields in the Gulf of Mexico. Total imports of goods and services are forecast to expand at an annual rate of 11 percent during the second half of this year, 9 percent next year, and 7 percent in 1999.

**Oil prices.** The staff has raised its projections slightly for the price of imported oil in the near term because of the strength of U.S. economic activity and the interruption of oil export flows from Colombia. For the third quarter, the price has been revised up \$0.41 per barrel to \$17.31. We project that the price of imported oil will fall somewhat during the fourth quarter, with the return of Iraqi and Colombian exports to the world market and a projected increase in North Sea production, but will rise subsequently. Non-OPEC producers are having difficulty bringing new fields under development into production within their planned time period. Many of the planned projects are technologically ambitious, especially the development of offshore fields. Another factor for the delays is the overall tightness in the offshore rig market. Finally, the development of several onshore fields has been delayed by problems in securing pipeline routes.

**Prices of non-oil imports and exports.** The prices of non-oil imports of core goods are projected to fall a bit further this quarter but then to rise over the remainder

of the forecast period at an increasing rate. The acceleration in core import prices results in part from the switch from dollar appreciation earlier this year to a flat dollar and then depreciation in 1999. In addition, projected declines in non-oil commodity prices through 1998 hold down core import prices in the near term, but not in late 1998 and 1999. Prices of core nonagricultural exports are also projected to decline in the near term and to rise subsequently at an increasing rate in line with comparable U.S. domestic prices.

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

Trade category	Projection				
	1997			1998	1999
	H1	Q3	Q4		
<i>Exports</i>					
Nonagricultural (core)	0.9	-0.3	-0.2	1.2	1.7
Agricultural	-10.8	-13.0	-3.6	2.1	2.0
<i>Imports</i>					
Non-oil (core)	-1.2	-0.4	0.8	0.6	1.9
Oil (level, dollars per barrel)	18.00	17.31	16.48	16.94	18.50

NOTE. Prices for exports and non-oil imports of goods exclude computers and semiconductors and are on a NIPA chain-weighted basis.

The price of imported oil for multiquarter periods is the price for the final quarter of the period.

**Nominal trade and current account balances.** The nominal trade deficit on goods and services is expected to widen from \$105 billion in the second quarter of this year to \$140 billion at the end of 1999. The deficit on net investment income is projected to increase by about \$20 billion over that same interval. We project that the current account deficit will average \$167 billion or 2 percent of GDP this year but will widen to \$215 billion or 2-1/2 percent of GDP in 1999.

OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES  
(Percent, Q4 to Q4)

Measure and country	1991	1992	1993	1994	1995	1996	---- Projected ----		
							1997	1998	1999
<b>REAL GDP</b>									
Canada	0.0	0.5	3.1	4.9	0.7	2.3	4.0	3.1	2.3
Japan	2.5	0.1	0.4	0.8	2.6	3.0	-0.0	2.5	2.5
United Kingdom	-1.6	0.4	2.7	4.9	2.0	2.9	3.2	1.9	1.6
EU-11 Average (1)	2.1	0.1	-0.1	3.5	1.3	1.9	2.7	2.7	2.9
of which:									
France	1.3	-0.0	-0.5	4.3	0.3	2.1	2.4	2.5	2.5
Germany (2)	3.3	0.9	-0.2	3.4	0.7	2.1	2.8	2.7	3.2
Italy	1.9	-0.8	0.1	2.7	2.3	0.2	2.4	2.4	3.1
Foreign G-7 Average weighted by 1991 GDP	1.7	0.2	0.6	2.9	1.7	2.3	1.9	2.5	2.6
Average weighted by share of U.S. nonagricultural exports									
Total foreign	2.9	1.9	3.2	5.1	1.7	4.0	4.0	3.9	3.7
Foreign G-7	0.8	0.3	1.8	3.9	1.3	2.4	2.8	2.7	2.4
Developing Countries	6.4	5.1	6.0	7.0	2.1	6.8	5.8	5.8	5.7
<b>CONSUMER PRICES</b>									
Canada	4.1	1.8	1.8	0.0	2.1	2.0	1.9	2.1	2.2
Japan	3.2	0.9	1.2	0.8	-0.8	0.1	1.7	0.6	0.8
United Kingdom (3)	5.7	3.7	2.7	2.2	2.9	3.2	2.6	2.8	2.9
EU-11 Average (4)	NA	NA	NA	NA	2.7	2.0	1.6	1.9	2.1
of which:									
France	3.0	1.8	2.1	1.6	1.9	1.7	1.4	1.8	1.9
Germany (2)	4.0	3.4	4.2	2.6	1.7	1.4	2.0	2.1	2.2
Italy	6.1	4.9	4.1	3.8	5.9	2.7	1.8	2.0	2.5
Foreign G-7 Average weighted by 1991 GDP	4.1	2.4	2.5	1.8	1.6	1.5	1.8	1.6	1.8
Average weighted by share of U.S. non-oil imports									
	3.9	1.9	2.0	1.0	1.1	1.3	1.8	1.5	1.7

1. Includes all of the European Union countries except the United Kingdom, Denmark, Sweden, and Greece; weighted by GDP.
2. West German data through 1991; all Germany thereafter.
3. CPI excluding mortgage interest payments which is the targeted inflation rate.
4. Harmonized CPI's for the EU-11, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

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

Measure and country	1997				Projected 1998				1999			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>REAL GDP</b>												
Canada	3.7	4.9	3.8	3.4	3.2	3.3	3.1	2.8	2.5	2.4	2.3	2.1
Japan	5.7	-11.2	2.4	3.9	2.7	2.5	2.4	2.4	2.5	2.5	2.5	2.5
United Kingdom	3.3	4.0	3.2	2.4	2.1	1.9	1.8	1.7	1.7	1.6	1.6	1.6
EU-11 Average (1)	0.9	4.5	3.0	2.6	2.6	2.6	2.7	2.7	2.9	2.8	3.0	3.0
of which:												
France	1.0	4.0	2.3	2.3	2.6	2.4	2.5	2.4	2.5	2.5	2.5	2.5
Germany	1.2	4.1	3.4	2.5	2.6	2.7	2.8	2.6	3.1	3.1	3.2	3.3
Italy	-0.7	6.0	2.5	2.0	2.3	2.3	2.5	2.5	2.7	2.7	3.5	3.5
Foreign G-7 Average weighted by 1991 GDP	2.8	-0.9	2.8	2.9	2.6	2.5	2.5	2.4	2.5	2.5	2.6	2.6
Average weighted by share of U.S. nonagricultural exports												
Total foreign	3.4	4.4	4.0	4.1	3.9	3.9	3.8	3.9	3.7	3.7	3.6	3.6
Foreign G-7	3.5	1.3	3.3	3.1	2.8	2.8	2.7	2.5	2.4	2.4	2.4	2.3
Developing Countries	4.2	8.1	5.3	5.7	5.7	5.8	5.7	5.8	5.7	5.8	5.7	5.8
<b>CONSUMER PRICES (2)</b>												
Canada	2.1	1.6	1.9	1.9	1.9	2.0	2.0	2.1	2.1	2.1	2.1	2.2
Japan	0.0	1.5	1.6	1.7	1.8	0.2	0.4	0.6	0.8	0.8	0.8	0.8
United Kingdom (3)	2.9	2.6	2.8	2.6	2.6	2.7	2.8	2.8	2.8	2.9	2.9	2.9
EU-11 Average (4)	1.7	1.2	1.6	1.6	1.9	1.8	1.9	1.9	2.0	2.0	2.1	2.1
of which:												
France	1.5	0.9	1.3	1.4	1.6	1.5	1.8	1.8	1.9	1.9	1.9	1.9
Germany	1.7	1.6	2.0	2.0	2.0	2.0	2.0	2.1	2.1	2.1	2.2	2.2
Italy	2.4	1.6	1.6	1.8	2.0	2.0	2.0	2.0	2.3	2.3	2.5	2.5
Foreign G-7 Average weighted by 1991 GDP	1.4	1.6	1.8	1.8	2.0	1.4	1.5	1.6	1.7	1.8	1.8	1.8
Average weighted by share of U.S. non-oil imports												
	1.3	1.6	1.8	1.8	1.9	1.3	1.4	1.5	1.6	1.6	1.7	1.7

1. Includes all of the European Union countries except the United Kingdom, Denmark, Sweden, and Greece; weighted by GDP.
2. Percent change from same period a year earlier.
3. CPI excluding mortgage interest payments which is the targeted inflation rate.
4. Harmonized CPI's for the EU-11, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.



OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1991	1992	1993	1994	1995	1996	----- 1997	Projected 1998	----- 1999
<b>NIPA REAL EXPORTS and IMPORTS</b>									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	0.4	-0.4	-0.6	-0.4	0.4	-0.4	-0.6	-0.4	-0.3
Exports of G&S	0.8	0.4	0.5	1.1	1.2	1.1	1.6	1.1	0.9
Imports of G&S	-0.4	-0.8	-1.1	-1.4	-0.7	-1.6	-2.1	-1.5	-1.2
Percentage change, Q4/Q4									
Exports of G&S	8.6	4.1	4.6	10.0	10.3	9.3	12.3	7.6	6.1
Services	7.1	-0.9	4.1	6.0	9.0	4.7	2.5	2.6	3.5
Agricultural Goods	10.1	10.4	-5.5	16.6	-3.4	5.7	2.4	0.0	1.9
Computers	21.7	25.2	23.7	32.0	55.7	33.8	67.1	45.8	43.1
Semiconductors	41.8	64.8	32.9	66.9	80.4	45.9	34.3	41.2	41.2
Other Goods 1/	7.0	2.3	3.6	6.9	5.7	7.6	13.2	5.2	1.5
Imports of G&S	4.1	7.4	10.2	12.3	5.6	11.8	14.9	9.2	7.0
Services	-2.7	1.4	3.2	1.4	7.3	5.0	11.0	3.5	2.0
Oil	8.1	12.1	10.1	-0.2	1.5	8.3	0.5	3.2	1.8
Computers	35.9	45.1	39.3	44.8	46.2	23.6	55.0	40.0	39.5
Semiconductors	55.3	42.0	34.2	54.5	92.7	57.9	45.0	41.8	40.6
Other Goods 2/	2.5	5.4	9.5	12.2	-1.2	10.5	12.7	6.7	3.7
Billions of chained 1992 dollars									
Net Goods & Services	-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-139.3	-165.1	-194.8
Exports of G&S	599.9	639.4	658.2	712.4	791.2	857.0	969.5	1061.5	1124.3
Imports of G&S	622.2	669.0	728.4	817.0	890.1	971.5	1108.8	1226.6	1319.1
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-4.5	-55.4	-90.5	-133.5	-129.1	-148.2	-167.4	-183.5	-214.0
Net Goods & Services (BOP)	-29.9	-38.3	-72.0	-104.4	-101.9	-111.0	-112.0	-114.6	-138.7
Exports of G&S (BOP)	580.7	617.7	643.0	699.7	794.6	848.8	933.1	1010.0	1068.9
Imports of G&S (BOP)	610.6	655.9	715.0	804.1	896.5	959.9	1045.2	1124.5	1207.6
Net Investment Income	20.3	18.0	19.7	9.7	6.8	2.8	-15.4	-27.2	-33.6
Direct, Net	55.6	51.6	55.7	50.8	60.0	66.8	68.3	69.2	78.4
Portfolio, Net	-35.4	-33.6	-36.0	-41.0	-53.2	-63.9	-83.7	-96.4	-112.0
Net Transfers	5.1	-35.2	-38.1	-38.8	-34.0	-40.0	-40.0	-41.8	-41.8

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1994				1995				1996			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
	Percentage point contribution to GDP growth											
Net Goods & Services	-1.1	-0.4	-0.4	0.3	-0.5	0.0	1.2	1.0	-1.5	-0.7	-1.5	1.9
Exports of G&S	-0.2	1.7	1.1	1.5	0.8	1.0	1.5	1.3	0.2	1.1	0.2	2.9
Imports of G&S	-0.9	-2.1	-1.5	-1.2	-1.2	-1.0	-0.3	-0.3	-1.7	-1.8	-1.7	-0.9
	Percentage change from previous period, SAAR											
Exports of G&S	-1.8	17.7	10.6	14.7	7.2	9.3	13.5	11.5	1.7	9.6	1.9	25.5
Services	2.4	12.9	2.0	6.9	6.0	3.8	20.3	6.6	-3.8	9.7	0.3	13.5
Agricultural Goods	-25.2	8.1	45.3	57.2	-1.3	-17.5	19.7	-10.7	12.5	-34.3	13.1	49.2
Computers	21.4	24.3	35.5	48.4	34.9	41.0	89.6	63.1	46.2	31.8	29.2	28.7
Semiconductors	111.8	23.4	65.9	79.1	72.0	97.0	100.3	56.2	19.9	28.3	37.6	113.8
Other Goods 1/	-6.8	20.3	7.4	8.6	2.9	8.2	1.0	11.0	-1.2	13.2	-3.1	23.9
Imports of G&S	7.6	19.0	13.1	9.9	10.0	7.7	2.3	2.4	13.1	14.1	13.2	6.8
Services	2.7	4.1	-0.4	-0.9	24.4	-4.0	8.4	2.2	14.6	2.7	1.2	2.1
Oil	-8.6	27.2	33.5	-36.2	-8.1	12.5	28.0	-19.7	-7.6	67.2	10.6	-19.6
Computers	32.9	48.3	42.3	57.0	8.1	57.3	65.8	61.8	6.4	30.7	26.9	32.0
Semiconductors	60.7	23.7	74.4	64.3	29.6	108.0	157.1	98.8	30.4	10.3	75.5	146.4
Other Goods 2/	6.9	19.6	10.3	12.5	7.3	2.2	-10.0	-3.6	14.5	11.0	12.2	4.3
	Billions of chained 1992 dollars											
Net Goods & Services	-97.6	-103.9	-111.1	-105.9	-113.5	-112.8	-92.9	-76.1	-100.8	-112.6	-138.9	-105.6
Exports of G&S	676.0	704.1	722.1	747.3	760.4	777.4	802.4	824.6	828.2	847.4	851.4	901.1
Imports of G&S	773.6	808.0	833.2	853.2	873.9	890.3	895.4	900.7	929.0	960.0	990.2	1006.6
	Billions of dollars											
US CURRENT ACCOUNT BALANCE	-104.6	-128.0	-145.5	-156.1	-138.8	-142.8	-132.5	-102.2	-131.5	-142.3	-171.3	-147.5
Net Goods & Services (BOP)	-90.6	-101.5	-114.0	-111.6	-113.2	-123.2	-95.5	-75.5	-98.2	-111.1	-130.1	-104.8
Exports of G&S (BOP)	662.5	688.4	710.9	736.8	761.5	785.9	806.4	824.6	828.4	848.6	840.3	878.0
Imports of G&S (BOP)	753.1	789.9	824.9	848.4	874.7	909.1	901.9	900.1	926.6	959.7	970.4	982.8
Net Investment Income	17.9	10.6	7.2	3.3	8.2	12.9	-1.6	7.8	8.2	3.5	-5.5	5.0
Direct, Net	51.7	48.9	51.0	51.5	57.6	64.1	53.9	64.5	66.2	64.2	60.3	76.4
Portfolio, Net	-33.8	-38.3	-43.8	-48.2	-49.4	-51.3	-55.5	-56.7	-57.9	-60.7	-65.7	-71.4
Net Transfers	-31.9	-37.1	-38.7	-47.7	-33.8	-32.5	-35.4	-34.5	-41.6	-34.8	-35.8	-47.7

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

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1997				Projected 1998				1999			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.2	-0.4	-1.1	0.4	0.0	-0.9	-1.1	0.3	-0.6	-0.2	-0.8	0.4
Exports of G&S	1.2	2.4	0.7	1.9	1.5	0.9	0.3	1.4	0.5	1.2	0.4	1.5
Imports of G&S	-2.4	-2.8	-1.8	-1.4	-1.5	-1.8	-1.4	-1.1	-1.1	-1.4	-1.2	-1.1
Percentage change from previous period, SAAR												
Exports of G&S	9.9	20.2	4.9	14.7	11.4	6.5	2.4	10.1	3.4	8.2	2.5	10.7
Services	3.7	3.5	1.4	1.4	2.0	2.7	2.7	3.0	3.5	3.5	3.5	3.6
Agricultural Goods	-27.6	20.9	7.2	17.0	-7.2	-3.7	3.8	7.8	2.0	-5.6	3.9	7.8
Computers	72.3	85.5	60.8	51.8	49.1	46.4	43.8	43.8	43.8	43.3	42.7	42.7
Semiconductors	39.0	15.3	41.2	43.8	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2
Other Goods 1/	12.4	25.1	0.2	16.5	13.2	3.9	-3.9	8.5	-2.9	6.0	-5.0	8.5
Imports of G&S	17.9	20.5	12.0	9.6	9.7	11.4	9.1	6.7	6.5	8.3	7.0	6.3
Services	24.2	9.5	5.7	5.6	5.1	3.7	2.7	2.5	2.2	2.0	1.9	1.9
Oil	-10.8	44.6	-6.3	-15.6	-9.4	33.3	10.9	-15.5	-11.3	26.5	2.7	-6.8
Computers	51.3	71.6	51.8	46.4	40.7	39.7	39.8	40.0	39.5	39.5	39.6	39.4
Semiconductors	71.2	19.1	50.7	43.8	42.7	42.2	41.1	41.4	40.6	40.6	40.8	40.4
Other Goods 2/	15.3	17.0	10.5	8.3	8.3	7.6	6.1	4.9	4.2	3.7	3.5	3.3
Billions of chained 1992 dollars												
Net Goods & Services	-126.3	-132.9	-152.9	-145.0	-144.5	-160.2	-180.6	-175.0	-186.0	-190.1	-205.7	-197.4
Exports of G&S	922.7	966.0	977.7	1011.7	1039.4	1056.0	1062.4	1088.3	1097.3	1119.2	1126.0	1154.9
Imports of G&S	1048.9	1098.9	1130.6	1156.7	1183.9	1216.2	1243.0	1263.2	1283.3	1309.3	1331.7	1352.3
Billions of dollars												
US CURRENT ACCOUNT BALANCE	-159.9	-156.9	-175.5	-177.4	-163.1	-175.3	-195.3	-200.3	-200.4	-205.2	-222.7	-227.7
Net Goods & Services (BOP)	-117.2	-106.6	-118.8	-105.6	-99.9	-110.4	-127.6	-120.3	-131.0	-134.6	-148.9	-140.2
Exports of G&S (BOP)	897.0	936.2	935.1	964.1	989.7	1004.9	1010.4	1034.9	1043.4	1064.5	1070.3	1097.6
Imports of G&S (BOP)	1014.2	1042.8	1053.9	1069.8	1089.6	1115.3	1138.0	1155.1	1174.4	1199.0	1219.2	1237.7
Net Investment Income	-8.0	-14.1	-17.7	-21.7	-24.2	-25.9	-28.7	-30.1	-30.3	-31.7	-34.8	-37.6
Direct, Net	69.3	69.5	67.7	66.7	66.9	68.0	69.5	72.6	74.5	77.6	79.6	81.9
Portfolio, Net	-77.3	-83.6	-85.3	-88.4	-91.1	-93.9	-98.1	-102.6	-104.9	-109.3	-114.4	-119.4
Net Transfers	-34.7	-36.3	-39.0	-50.0	-39.0	-39.0	-39.0	-50.0	-39.0	-39.0	-39.0	-50.0

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