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Strictly Confidential (FR) Class II FOMC

Part 1

January 28, 1998

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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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SUMMARY AND OUTLOOK

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Domestic Developments

Overview

The run of good news on the U.S. economy has continued in recent weeks, with further indications of rapid growth, large employment gains, and low price inflation. We believe, however, that economic performance will become more mixed in the period immediately ahead, owing mainly to a sharp deterioration in the nation's trade balance. The financial strains in East Asia are forcing an abrupt current-account adjustment there, which will be reflected in a weakening demand for U.S. exports and an intensification of competition from imports.

Domestic demand likely will be buoyed in the short run by the still generally favorable financial environment here. To be sure, real short-term interest rates have been drifting upward, but rates on intermediate- and long-term debt evidently are quite attractive to borrowers, lenders remain active in seeking out customers, and the stock market has held up in the face of some downgrading of earnings expectations and new political uncertainties. In due course, however, the drag from the external sector will slow the growth of production, employment, and income, in turn retarding the expansion of domestic spending. We expect that, by this spring, real GDP growth will have dropped below the trend rate of potential and that growth will remain subpar on average through next year, resulting in an easing of pressures on productive resources.

Crude oil prices have come down on net in recent weeks, and prices of other commodities have moved lower as well. These developments suggest that the string of favorable reports on inflation has not yet ended. With non-oil import prices likely to decline appreciably in the near term, and with pressures on domestic industrial capacity likely to ease, the prices of consumer goods should be flat to down in the first half of 1998; overall CPI inflation should be even lower than it has been on average in the past year. We believe that the uptrend in the dollar is now coming to an end, and nonoil import prices should begin to firm by mid-year; oil prices also may turn back up around that time. Even so, with the ongoing reduction in pressures on domestic resources, we foresee core CPI inflation (on a consistently measured basis) picking up to a pace in 1999 that is only a shade higher than that in 1997.

Key Background Factors

While the federal funds rate has remained stable at 5-1/2 percent, the bond and stock markets have moved erratically over the intermeeting period. Demand for dollar-denominated securities was strengthened for much of the time by anxiety about the evolving Asian situation, but the "safe haven" attraction of these instruments seems to have been diminished in the past week or so by hopeful signs of constructive policy action abroad and by uncertainties about President Clinton's political future. Bond yields, which had in some instances reached new lows for the cycle, backed up to near levels prevailing at the time of the last FOMC meeting. Stock prices also have gyrated in recent weeks, but are up slightly on balance. Most firms met or exceeded analysts' latest expectations in their quarterly earnings announcements, but a number of large companies issued warnings that underscored the problems ahead associated with the Asian slump and the adverse exchange-rate effects on the translation of foreign earnings.

Looking ahead, we have retained our basic monetary policy assumption that the federal funds rate will not deviate appreciably from its current level during the next two years. Given the slow growth and low inflation we are projecting, long-term Treasury yields over coming months may well fall back to, perhaps for a time even below, the lows of the recent period, and we see little reason for more than a mild rebound through 1999. This implies an unusually flat yield curve, for an extraordinarily long period, but the prevailing economic environment should minimize concerns that inflation might flare up or that monetary policy might be tightened. At the same time, however, we think that share prices will fall at least moderately. Although the market appears now to have a somewhat more sober view of earnings prospects than it did last month, the combination of slowing volume growth and some squeeze on margins probably will lead to more of a deterioration in profits than is now anticipated. The projected decline in share prices is considerably less than it was in the December Greenbook, but it still results in a notable downturn in the wealth-to-income ratio in the household sector.

Risk premiums in the fixed-income markets have reflected little, if any, concern about the effects of slowing growth or of the much discussed "deflationary" pressures on the probability of debt repayment problems. We would expect only a slight widening of those premiums during the projection period. Moreover, in loan markets, banks and other institutions do not appear likely to tighten up much on credit terms or availability.

Broad measures of the exchange value of the dollar have appreciated further since the last FOMC meeting, owing primarily to declines in the currencies of our troubled Asian trading partners. We expect the dollar's value to remain about constant in nominal terms; in light of the escalation of inflation in Asia, we are anticipating a moderate depreciation of the dollar in real terms. But that depreciation is dwarfed by the substantial real appreciation of the dollar over the past two years, which results in a continuing deterioration of net exports throughout the projection period. Meanwhile, our forecast for foreign economic growth has been marked down about 1/2 percentage point to near 2 percent in 1998; growth was close to 4 percent last year. We expect that the Asian economies will begin to recover by the end of this year, though, and we are projecting foreign growth of around 3 percent in 1999.

In the December Greenbook, we predicted a substantial decline in oil prices, in part because of OPEC's announcement that it was increasing its production ceiling. In the event, spot oil prices moved down even more rapidly than we had anticipated, but they have retraced some of that decline in the past couple of days owing to heightened uncertainties about Iraq; on net, the price today is about $1.25 per barrel lower than at the time of the last FOMC meeting. Our outlook is predicated on only a very gradual increase in oil prices from these low levels; slow world growth should prevent demand from pressing hard on increasing supplies.

Although some have argued that prospective surpluses should be used to cut taxes or to increase spending, we are assuming that there will be no notable net changes in fiscal policy. (We are anticipating that the Congress will approve pending IMF funding requests; this does not require an increase in budgeted expenditures.) Our economic projection leads us to expect that the federal budget will be marginally in deficit in fiscal years 1998 and 1999.

Recent Developments and Outlook for the Current Quarter

The data in hand show that economic activity rose strongly in the fourth quarter, though our estimate that real GDP rose at almost a 4 percent annual rate still has some awkward question marks attached to it. The tension we noted last month between exceptionally strong labor market and industrial production indicators on the one side and less impressive spending indicators on the other has not been fully resolved by the incoming information

Real consumer spending appears to have decelerated more last quarter than we had expected, to a growth rate of about 3 percent; the level of real business fixed investment evidently was about unchanged. Offsetting these downside surprises is our estimate, based on a more positive November merchandise trade report, that net exports rose rather than declining further as we had been expecting. We have assumed a large increase in inventories in December, on top of the sizable increments indicated by the October-November figures for manufacturing and trade, which would put growth of nonfarm stocks at more than a 5 percent rate last quarter--contributing nearly a percentage point to GDP growth. But, with manufacturing output having risen at more than an 8 percent rate, even that assumption leaves a discomforting gap between apparent goods production and the goods expenditure in our GDP total. BEA will be taking its first crack at adding things up this Friday, and the agency clearly has a good deal of room to come to

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

Measure	1997:Q4 Dec. GB	1997:Q4 Jan. GB	1998:Q1 Dec. GB	1998:Q1 Jan. GB
Real GDP	**3.9**	**3.9**	**2.0**	**2.7**
Private domestic final purchases	4.2	2.7	4.2	5.4
Personal consumption expenditures	3.5	2.9	4.1	4.7
Residential investment	8.4	8.1	-.7	1.7
Business fixed investment	7.5	-.4	7.3	11.7
Government outlays for consumption and investment	1.1	.9	-1.6	-1.1
	Change, billions of chained (1992) dollars			
Inventory investment	11.6	17.9	-4.2	-3.1
Net exports	-9.6	10.8	-22.2	-30.2

a different conclusion while we both await further data to fill the gaps in the statistical puzzle.

Turning to the current quarter, we are forecasting that GDP growth will slow considerably, to around a 2-3/4 percent rate. At this point, we have practically no hard data for the period. Perhaps the most solid indicator is initial claims for unemployment insurance--and it can be a pretty shaky guide at this time of the year, because of huge seasonal swings. But, for what it is worth, claims have remained low enough to suggest that payroll employment growth will continue to look fairly hefty in the January labor market report. We are anticipating a notable slowing of employment gains by the end of the quarter.

Sketching out the ingredients in our first-quarter GDP forecast, we expect net exports to more than account for the fall-off in growth, subtracting nearly 1-1/2 percentage points of growth this quarter after having added about 1/2 point in the fourth quarter. To be sure, not all of that 2-point swing reflects weakness abroad--the residual seasonality in the trade data accounts for a portion of it--but we do think that the slowdown in Asia will begin to take a more noticeable toll of final demand this quarter. The decline in the Purchasing Managers' index for new export orders in December suggests that the slowdown in foreign demand has already begun. Anecdotal reports from the Reserve Banks point to capital goods and farm products as the sectors most likely to lose foreign sales in coming months.

At the same time, though, domestic demand probably has not yet run out of steam. Indeed, we project that private domestic final purchases will rise briskly this quarter, increasing at nearly a 5-1/2 percent annual rate after rising at "only" a 2-3/4 percent rate in the fourth quarter. Various reports from retailers suggest that consumer spending showed renewed vigor in the early part of this year, which is not surprising in light of the positive fundamentals undergirding demand. In addition, we read the trends in orders at U.S. manufacturers of capital goods as pointing to a pickup in business fixed investment in the current quarter. The reacceleration in these two more sizable components of spending should offset by far the modest negative effect of a tailing off in the growth of residential investment; demand indicators in this sector have remained strong, but the flatness of single-family starts in the past couple of quarters will be mirrored in estimates of near-term construction outlays.

Businesses added substantially to inventories last year, at a pace that greatly exceeded that of final sales. That accumulation probably was intended, among other things to rebuild stocks depleted by the surprising pickup of activity in 1996 and to support the major ramp-up of production of commercial aircraft. At this point, many firms appear to be anticipating a slowing of economic growth this year, and they may be preparing to gear down inventory investment to a more moderate pace. However, we suspect that the drop-off in sales over the next few months will be sharper than they are anticipating, and we expect that production will not decelerate enough to avoid some pile-up of excess stocks.

As noted above, the near-term prospects on the inflation front remain auspicious. To be sure, the tightness of the labor market does appear to be causing some acceleration of wages. However, the sharp fourth-quarter increase in the ECI for hourly compensation was exaggerated by a surge in commissions and bonuses in the finance sector; in addition, there appears to have been some lagged effect of the September hike in the minimum wage. Although the level of hourly compensation in the finance industry is likely to remain high for another quarter, we expect the rise in the overall ECI to moderate considerably in the current quarter. In addition, falling materials prices and weak prices of imports generally should damp inflation. We project that the CPI excluding food and energy will rise at a 2 percent annual rate this quarter and that falling energy prices will hold the overall CPI to an increase of only 1/2 percent.[1]

The Outlook for the Economy beyond the Current Quarter

Most of the macro dynamics that we outlined in December are present in this projection as well. The troubles in Asia, a slowing of inventory investment, and a decline in equity prices all contribute to a marked deceleration in aggregate demand this year. In addition, with our assumption that the nominal federal funds rate remains unchanged, a small reduction in inflation this year implies a slight further rise in real short-term interest rates. However, given that the projected decline in the stock market is less severe than in the December forecast, we are somewhat more optimistic about growth prospects in 1999 than we were at the time of the last Greenbook.

Real GDP now is projected to rise at an annual rate of just under 1-1/2 percent over the final three quarters of this year, and then to pick up to almost a 2 percent rate of increase during 1999. Given this below-trend growth, the unemployment rate is expected to move up to 5-1/4 percent by the end of 1999--as in our last forecast. However, our reading of the strength of manufacturing investment has led us to elevate our forecast of factory capacity, so that the utilization rate falls even more than it did in our prior projection. This additional slack has contributed to a further trimming of our price forecast, so that, after allowance for the effects of technical changes to the index, we project only the mildest uptick in the core CPI inflation rate through 1999.

Consumer spending. Consumer demand is likely to provide impetus to economic activity over the next few quarters, and real PCE is projected to rise 3-1/2 percent this year. Sentiment is historically high--which is not surprising, given the strong uptrend in employment and income and the whopping increase in stock market wealth that households have enjoyed over the past three years. Furthermore, the wave of refinancing triggered by the recent decline in mortgage rates ought to provide a modest additional boost to spending in the coming months. These factors should sustain sizable gains in consumption, even as other forces begin to retard job and income growth, and the personal saving rate is projected to decline.

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1. With the January CPI, the BLS will introduce its updated market basket and a hedonic index to adjust computer prices for quality improvements. In 1999, the BLS intends to modify its sample-rotation procedures, and it likely will adopt a geometric-means formula for calculating price changes within many strata. We expect that these changes will hold down the increase in the CPI by a total of 0.3 to 0.4 percentage point over the next two years, relative to 1997 methodology.

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

Measure	1997	1998	1999
Real GDP	**3.8**	**1.7**	**1.9**
Previous	3.9	1.7	1.4
Final sales	3.3	2.4	1.8
Previous	3.4	2.2	1.5
PCE	3.7	3.5	2.1
Previous	3.8	3.4	1.7
Residential investment	5.4	.6	-.3
Previous	5.7	-1.6	-1.0
BFI	9.1	7.7	5.4
Previous	10.8	7.6	5.6
Government purchases	1.1	.6	.9
Previous	1.2	.4	.9
Exports	10.5	.5	4.1
Previous	10.5	3.8	5.8
Imports	14.1	7.9	6.5
Previous	15.9	10.5	7.8
	Change, billions of chained (1992) dollars		
Inventory change	32.5	-52.3	12.2
Previous	30.5	-40.8	-11.1
Net exports	-47.7	-86.2	-40.0
Previous	-65.9	-85.1	-40.5

By next year, however, the lagged effects of last year's stock market advance are expected to be counterbalanced by those of this year's projected downturn. We are projecting that real PCE growth will run only about 2 percent over the four quarters of 1999, matching the expansion of disposable income. This slowdown probably will be widespread, but we are looking for especially large effects among durable goods items, which tend to be quite cyclical, and many discretionary services.

Residential investment. For many of the same reasons as apply for consumption spending, the demand for single-family housing ought to be maintained in the coming months at its recent high level. Although slower income growth and the declining stock market ultimately will restrain activity, low mortgage rates should provide some buoyancy to this sector in the near term. Traditional measures of cash-flow affordability, relating mortgage payments to income, show current conditions for homebuying to be the most favorable in decades--and that is mirrored in the attitudes expressed in recent surveys. Moreover, real estate prices apparently have firmed enough in many locales to encourage potential buyers to invest now rather than deferring home purchases. On the other hand, because the level of housing construction has been high for some time--high enough to produce a notable rise in the nation's homeownership rate--we think there are some limits to profitable building opportunities. Balancing out these factors, our projection has single-family starts only edging off marginally over the next two years.

The multifamily sector has been a big surprise of late. Neither we nor other analysts foresaw the marked run-up of starts reported for the closing months of 1997. Nonetheless, some positive developments underlie the recent strength in the sector: Apartment vacancy rates have edged down a little, and real rents have been trending up--two occurrences that suggest some tightening in this market that would be conducive to a pickup in construction activity; and the vibrant job market may be providing more young people the wherewithal to leave home and set up independent households. However, our judgment is that the recent level of starts is not economically sustainable, and we are expecting a drop back from the 400,000 unit pace of the fourth quarter to the low- to mid-300,000's over the projection period. The risk to this forecast may be that the abundance of financing now available will cause builders to undertake more projects than the fundamentals warrant, at least for a while. However, given the relatively low value per unit in this sector (roughly $60,000 per start versus nearly $150,000 for singles), our projection of real GDP is not very sensitive to the level of multifamily starts.

Business fixed investment. Capital spending remains a bright spot in the outlook, but the 7-3/4 percent rise in real business fixed investment we are predicting for this year does represent a step-down from last year's 9 percent increase. The same considerations that have prompted a variety of firms to issue warnings of weaker profitability in recent weeks likely are causing at least some of them also to take a somewhat more cautious attitude toward capital outlays for this year. With "accelerator" effects turning more negative in 1999, and with cash flow slowing and external financing costs rising a bit, we are projecting that BFI growth will slow further, to 5-1/2 percent.

Equipment spending more than accounts for the predicted deceleration in BFI. Real outlays for producers durables are expected to slow from 13 percent last year to a little over 9 percent in 1998 and to moderate appreciably further in 1999. The drop-off would be sharper were it not for our expectation that rapidly changing technology, declining relative prices, and some extra replacement demand stimulated by efforts to solve the Year-2000 problem will be continuing to spur further investment in information processing equipment. Spending on computers and communications equipment ought to be substantial, although growth is unlikely to match the earlier torrid rates. Meanwhile, Boeing's production plans suggest that aircraft deliveries will be leveling off in the near future; financial difficulties in Asia may lead to some reallocation of slots to domestic air carriers, but we anticipate only modest growth in this BFI category over the projection period. At the same time, we expect to see a notable slowdown in spending on motor vehicles and more traditional industrial and commercial equipment items--which constitute about half of equipment spending; indeed, we anticipate that capital outlays by manufacturers will have turned down by 1999, as firms move to curb capacity expansion in light of declining utilization and profitability.

Regarding investment in nonresidential structures, almost everything looks strong except for the recent construction data themselves. Vacancy rates have moved lower in this sector, and property values and rents have been rising faster than overall inflation, suggesting that the supply-demand balance has been shifting in a direction favoring more building activity. There is increasing talk of speculative projects being undertaken in the office sector, and financing appears to be generously available from REIT investors and from banks and other lenders. Thus, after a pause indicated by the NIPA figures last year, we expect that spending on nonresidential structures will rise moderately in 1998 and 1999.

Inventory investment. As mentioned above, our projection embodies a significant slowing this year in the pace of nonfarm inventory investment, enough to hold down GDP growth by more than 1/2 percentage point. We are anticipating that the drop-off will begin in the spring and that, by the end of the year, stocks will be rising in line with the reduced rate of sales growth. Inventories are a roughly neutral influence on our projection of GDP growth in 1999, with stock accumulation essentially paralleling the growth of final sales.

We are guessing that the BEA data will show stocks of farm products having accumulated at a very rapid rate over the second half of 1997. Our forecast allows for further stockbuilding over the next couple of years, but at a more moderate pace. Inventory accumulation could be a bit larger if exports fall off sharply as a consequence of Asian economic problems. As it is, though, the projected slowdown in stockpiling shaves a tenth of a point off of real GDP growth in 1998. Once again, El Niño is an uncertainty in the outlook, but we have remained agnostic on the effects of the event--as seemingly have the futures markets.

Government spending. We are looking for real federal purchases to decline over the next two years. On our current estimate, they were essentially flat on balance in 1997, on a Q4/Q4 basis, but they have trended downward at roughly a 2 percent per annum rate thus far in the 1990s and the budget appears to point to a similar rate of decline over the projection period. As in previous projections, this contraction occurs mainly in the defense area, but caps on discretionary spending should dictate a downturn in real nondefense purchases, too, in 1999.

Real purchases by state and local governments are projected to pick up a little in 1998-99, but, at a 2-1/4 to 2-1/2 percent rate of growth, the expected expansion still would represent a mild response to a lot of good financial news in the sector. Like the federal government, states and localities have enjoyed unexpectedly high tax revenues, and the decline in interest rates has reduced borrowing costs for capital projects (and afforded the opportunity for some refinancing of outstanding debts). However, political pressures still seem to be dictating restraint in spending--which will stand the units in good stead as the economy produces some revenue disappointments over the next two years.

Net exports. Because we have become slightly more pessimistic about the Asian economic situation, we now expect exports to rise more slowly than they did in our December projection. We now look for exports to be up just a bit in 1998, and to rise at a 4 percent rate in 1999. At the same time, though, imports are expected to slow somewhat more than in the last Greenbook, and on balance, the negative contribution of net exports to GDP is about the same as we projected in December. (A more detailed discussion of the prospects for net exports is contained in the *International Developments* section.)

Labor markets. As sales slow, firms will move to trim their labor input. There typically is a lag in this process, and in the present instance, many employers may be especially hesitant to lay off workers in what they see as a very tight labor market. However, that hesitancy is likely to dissipate as it becomes evident that the softening in demand is going to be of some duration. Moreover, the greater use of temps and other contingent workers may permit prompter adjustment of labor input to changes in output levels.

We are projecting that monthly payroll increases will average about 165,000 per month in the first quarter but will drop below 100,000 in the second and remain at that slow rate through 1999. With only a slight shrinkage in the workweek, this employment pattern implies a slackening in productivity gains in the nonfarm business sector to about 3/4 percent in 1998 and then a return to trend in 1999 at 1-1/2 percent.

On our current estimate, labor productivity growth slowed to a 1-1/2 percent rate in the fourth quarter, well below the pace of the prior couple of quarters and in line with

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	2.3	.8	1.5
Previous	1.2	2.4	.7	1.3
Nonfarm payroll employment	2.1	2.5	1.3	.8
Previous	2.1	2.5	1.1	.6
Household employment survey	2.1	2.1	1.0	.7
Previous	2.1	2.1	1.0	.5
Labor force participation rate[1]	66.9	67.1	67.1	67.1
Previous	66.9	67.0	67.1	67.1
Civilian unemployment rate[1]	5.3	4.7	4.8	5.2
Previous	5.3	4.6	4.8	5.3

1. Percent, average for the fourth quarter.

our December forecast. Our projection of productivity growth for 1998-99 also is little changed from December. As before, one might argue that there is some upside risk to this path: Although we have factored in the effects of high investment on capital-labor ratios, it is conceivable that firms are also reaping some benefits of improved technology and management techniques in enhanced "total factor productivity." On the other side, however, is the possibility that Year-2000 reprogramming efforts will eat significantly into productivity in the next couple of years. The wide range of estimates of the dimension of outlays for this purpose does not inspire great confidence, but we have the impression that a considerable amount of labor is being diverted from more productive uses to the revamping of existing code or other related activities. Even if one discounts considerably the numbers one hears, it is not difficult to envision productivity losses running to a couple of tenths of a percent in both 1998 and 1999. Under the circumstances, we feel our projection balances reasonably the risks in the outlook for output per hour.[2]

Given our projection of employment growth, we expect that the unemployment rate will bottom out at just over 4-1/2 percent in the first part of this year and then trend

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2. We have made no change to our previous assumptions that the trend rate of productivity growth increased from 0.8 percent in the first half of the decade to 1.2 percent in the second half *on a consistently measured basis*. As published, technical changes to the CPI that lower measured inflation and so raise measured real output growth would boost the estimate of trend productivity growth to 1.3 percent in 1998 and 1.5 percent in 1999.

upward, reaching 5-1/4 percent in late 1999. We are anticipating that labor force participation, which ticked up to 67.2 percent last month, will edge back down and hold at 67.1 percent throughout the projection. Welfare reform should push some current benefit recipients into the labor market, but the probable effect would appear to be small. And, although there currently seem to be a good many job vacancies, even for folks who do not have high-tech skills, the number of such vacancies ought to diminish as the labor market softens over the next two years, reducing somewhat the incentive to look for work.

Wages and prices. As has been noted, we are offering a slightly more optimistic inflation outlook in this projection. Several factors are behind this change. One is the lower path for oil and other commodity prices. A second is the downward revision to the path of manufacturing capacity utilization, which suggests that goods producers will continue to face significant competitive restraint on their price setting. And a third is the evidence that inflation expectations have been moving downward, including the recent sizable drop in the Michigan SRC survey measure of year-ahead expectations in early January.

We now expect the published core CPI, which increased 2.2 percent last year, to rise 2.1 percent in 1998 and 2 percent in 1999; the latter figure is 1/4 percentage point lower than we projected in December. On a consistently measured basis, those figures correspond to an acceleration of only 0.2 percentage point over the next two years. (Technical changes in the index subtract perhaps three- to four-tenths of a point from the reported inflation rate between 1997 and 1999.) The rise in the overall CPI is projected to slow to 1.6 percent in 1998 and then pick up to 2 percent in 1999, as energy prices turn back up.

This acceleration in the core CPI, small as it may be, reflects our belief that--though moderating factory utilization is a mitigating factor--we should not ignore the signals of inflationary pressure coming from the low unemployment rate. The acceleration also occurs in part because some of the exogenous forces that have held down price increases recently are expected to be temporary. As noted above, we expect that the dollar will not extend the marked uptrend of the past couple of years, and we are projecting that core non-oil import prices will stop declining around mid-year and will rise about 1 percent during 1999. With regard to oil, we may still have some good news ahead of us, but we expect energy prices to turn up around mid-year. The higher prices of fuels not only will affect the energy component of the CPI, but will also tend to raise airfares and the transport costs embedded in other core consumer goods and services.

Our projection shows hourly compensation rates decelerating over the next two years. We remain persuaded that the recent acceleration in pay is consistent with a

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

Measure	1996	1997	1998	1999
Consumer price index	3.2	1.9	1.6	2.0
Previous	3.2	1.9	1.8	2.2
Food	4.2	1.7	1.3	1.8
Previous	4.2	1.9	1.9	2.1
Energy	7.6	-1.0	-3.0	2.5
Previous	7.6	-.9	-1.8	1.7
Excluding food and energy	2.6	2.2	2.1	2.0
Previous	2.6	2.2	2.1	2.2
PCE chain-weighted price index	2.7	1.6	1.6	1.9
Previous	2.7	1.6	1.6	2.0
Excluding food and energy	2.3	1.7	1.9	1.8
Previous	2.3	1.7	1.8	2.0
GDP chain-weighted price index	2.3	1.9	1.7	1.7
Previous	2.3	1.9	1.8	1.9
ECI for compensation of private industry workers[1]	3.1	3.4	3.2	3.1
Previous	3.1	3.2	3.1	3.1
Prices of core non-oil merchandise imports	-.7	-1.6	-1.5	1.1
Previous	-.7	-1.8	-1.9	.8
	Percentage points			
MEMO: *Adjustments for technical changes to the CPI*[2]				
Core CPI	.2	.2	.4	.6
Core PCE	.1	.1	.1	.3
GDP chain price index	.0	.1	.1	.2

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

NAIRU somewhere in the vicinity of 5-1/2 percent; thus, the projected level of joblessness would imply, other things equal, a further pickup in compensation gains. However, we think that this force will be more than offset by the moderating influence on wages of falling CPI inflation. Also, wage growth has been boosted in the past two years by increases in the minimum wage. We do expect benefits costs to accelerate during the projection period, led by an expected 3-1/2 percent rise, on average, in employers' costs of health insurance; this figure is well up from an increase of only 1 percent last year, but below some of the scarier numbers bandied about of late. One obvious upside risk to our projection is that compensation could be boosted by larger increases in health insurance costs; a second is that we may see another hike in the minimum wage this year or next.

Money and Credit Flows

Total debt of domestic nonfinancial sectors of the economy is expected to grow 5-1/4 percent this year (on a year-end basis) and about 4-1/2 percent in 1999, exceeding the growth of nominal GDP by more than a percentage point in both years. Debt growth will be bolstered by demands of both the private sector and state and local governments. Given the minute budget deficits in prospect, federal borrowing is likely to remain very modest--quite possibly negative for marketable securities, owing to the issuance of savings bonds and other nonmarketable instruments.

Borrowing by nonfinancial businesses, in particular, should be brisk this year and next. There are no signs of an abatement in the net retirement of equity shares. Share repurchase programs remain popular for cash-rich firms, and though the merger wave may be near a crest, we foresee a hefty volume of merger and acquisition activity continuing for some time. Meanwhile, the stock market decline we are predicting should put a damper on gross issuance of new shares. Corporations thus are expected to rely more heavily on borrowed funds to finance rising capital outlays as profits come under pressure from slower sales growth and lesser productivity gains.

We expect investment-grade firms to have a variety of attractive debt options. With bond rates remaining at relatively low levels, the greater share of borrowing should be in long-term markets. But banks will continue to be heavily involved in merger-related financing. Nonfinancial businesses with less-than-investment-grade ratings likely will find quality spreads widening and lenders more cautious in a slow growth environment, but we do not envision significant restraints on the overall supply of business credit.

In the household sector, debt growth is expected to pick up slightly to a 6-1/2 percent pace this year and ease back near 5-3/4 percent in 1999. Home mortgage debt is projected to expand fairly rapidly, especially in 1998, as low interest rates help sustain the pace of home sales and, in the near term, spur some "cash-out" refinancings. Some households are likely to use refinancings as an opportunity to substitute lower rate--and tax-deductible--debt for outstanding consumer loans. (It may be noted as well that recent tax law changes, including the larger capital gains tax rate differential and new IRA options enhance the attraction of "arbitrage" against mortgage debt.) We expect consumer credit growth to remain near its recent moderate pace in 1998 and to slow somewhat further next year-- the result of softening sales of autos and other durable goods and ongoing substitution of home equity loans for consumer credit.[3]

Household debt-service burdens--thought historically high--currently appear manageable, and interest savings from mortgage refinancings should trim them moderately. Limited evidence for the fourth quarter suggests that delinquency rates on consumer debt may have stabilized, but banks and other lenders will be alert to signs of further deterioration in household sector credit quality. We expect more caution among lenders in their underwriting standards as unemployment turns upward, but not enough of a tightening to make credit supply conditions an important element in the spending outlook.

Debt growth of state and local governments picked up to 5-3/4 percent last year, spurred by a revival of refinancing issuance and strong new capital financing. We have projected only a slight slowing in 1998 and 1999, anticipating that low interest rates will continue to attract a sizable volume of advance refundings and allow governmental units to finance planned outlays at low costs.

Following strong growth early in the year, M2 is expected to slow appreciably over the forecast period, to a pace roughly in line with that of nominal GDP. The predicted leveling off of velocity is based on the assumptions that the opportunity cost of holding M2 assets will remain near its current level and that falling share prices will divert funds away from equity mutual funds. M3 also is projected to slow, though much less than M2. M3 should continue to be boosted by brisk, albeit slowing, bank credit growth and by increased use of money funds by businesses for cash management purposes.

Alternative Simulations

Our alternative simulations present the consequences of different assumptions about interest rates and the stock market. In the first alternative, the federal funds rate rises 25 basis points per quarter this year and remains a constant 100 basis points above the baseline forecast in 1999. These higher rates hold down real GDP growth 1/4 percent in 1998 and 3/4 percent in 1999. The unemployment rate rises to 5-3/4 percent by the end of

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3. A recent constitutional amendment in Texas eased restraints on second-mortgage lending and expanded the scope for home equity lending in that state. Although finance companies and large banks are heavily promoting home equity loans in Texas, there are still many limitations on the size and use of these loans. Thus, we do not expect this development to notably boost total household debt growth, though it likely will add to the substitution of mortgage debt for other forms of consumer credit.

Alternative Federal Funds Rate and Stock Market Assumptions
(Percent change, Q4 to Q4, except as noted)

Measure	1996	1997	1998	1999
Real GDP				
Baseline	3.2	3.8	1.7	1.9
Higher funds rate	3.2	3.8	1.4	1.1
Lower funds rate	3.2	3.8	2.0	2.7
No stock price decline	3.2	3.8	1.9	2.3
Civilian unemployment rate[1]				
Baseline	5.3	4.7	4.8	5.2
Higher funds rate	5.3	4.7	4.9	5.7
Lower funds rate	5.3	4.7	4.7	4.7
No stock price decline	5.3	4.7	4.7	5.0
CPI excluding food and energy				
Baseline	2.6	2.2	2.1	2.0
Higher funds rate	2.6	2.2	2.0	1.5
Lower funds rate	2.6	2.2	2.2	2.5
No stock price decline	2.6	2.2	2.1	2.1

1. Average for the fourth quarter.

1999, 1/2 point higher than in the baseline projection, and core consumer price inflation comes in 1/2 percentage point lower than baseline in 1999.

The second simulation reduces the funds rate a cumulative 100 basis points this year; the effects of this simulation are symmetric to those of the first.

Our third alternative simulation assumes that the value of equities remains constant relative to disposable personal income; this contrasts with the substantial decline in the wealth-to-income ratio in the baseline forecast. The federal funds rate is maintained at 5-1/2 percent. In this scenario, real GDP growth is boosted by two-tenths of a percentage point in 1998 and about four tenths of a point in 1999; the unemployment rate is down 1/4 percentage point by the end of 1999.[4] The effect on the CPI is slight, not only because of the small unemployment rate effect, but also because expectations of long-term inflation remain low. In the FRB/US model, these expectations are quite sluggish unless there is a significant change in the stance of monetary policy; in essence, people have come to expect that policymakers will move to prevent an acceleration in prices.

4. To carry out this simulation, we adjusted the FRB/US model to boost the speed with which changes in wealth influence personal consumption expenditures, matching that used in the judgmental projection; this provides a closer estimate of what the staff projection would look like under this alternative stock-market scenario. (Without such an adjustment, the FRB/US model would have projected a large portion of these effects to be delayed until 2000.)

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Class II FOMC

January 28, 1998

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

Interval		Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		12/11/97	01/28/98	12/11/97	01/28/98	12/11/97	01/28/98	12/11/97	01/28/98	12/11/97	01/28/98
ANNUAL											
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		5.9	5.9	3.8	3.8	2.1	2.1	2.4	2.3	4.9	4.9
1998		4.4	4.2	2.4	2.5	1.8	1.7	1.8	1.5	4.7	4.7
1999		3.2	3.5	1.4	1.7	1.8	1.7	2.1	2.1	5.1	5.0
QUARTERLY											
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	5.2	5.2	3.3	3.3	1.8	1.8	1.0	1.0	4.9	4.9
	Q3	4.9	4.6	3.4	3.1	1.5	1.4	2.0	2.0	4.9	4.9
	Q4	6.1	5.9	3.9	3.9	1.9	1.9	2.2	2.3	4.6	4.7
1998	Q1	4.2	4.4	2.0	2.7	2.2	1.8	1.5	0.5	4.6	4.6
	Q2	3.4	2.6	1.7	1.0	1.7	1.6	1.6	1.7	4.6	4.7
	Q3	3.3	3.1	1.6	1.5	1.6	1.6	2.0	2.1	4.7	4.7
	Q4	3.2	3.4	1.4	1.7	1.8	1.7	2.1	2.2	4.8	4.8
1999	Q1	3.3	3.7	1.2	1.8	2.0	1.9	2.2	2.1	4.9	4.9
	Q2	3.1	3.5	1.3	1.9	1.8	1.6	2.2	2.0	5.1	5.0
	Q3	3.3	3.7	1.4	2.0	1.8	1.7	2.2	2.0	5.2	5.1
	Q4	3.4	3.8	1.5	2.1	1.9	1.7	2.2	2.0	5.3	5.2
TWO-QUARTER[3]											
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	6.3	6.3	4.1	4.1	2.1	2.1	1.7	1.7	-0.4	-0.4
	Q4	5.5	5.2	3.6	3.5	1.7	1.7	2.1	2.1	-0.3	-0.2
1998	Q2	3.8	3.5	1.8	1.8	2.0	1.7	1.6	1.1	0.0	-0.0
	Q4	3.2	3.3	1.5	1.6	1.7	1.7	2.0	2.1	0.2	0.1
1999	Q2	3.2	3.6	1.2	1.8	1.9	1.8	2.2	2.1	0.3	0.2
	Q4	3.4	3.7	1.5	2.0	1.9	1.7	2.2	2.0	0.3	0.2
FOUR-QUARTER[4]											
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	5.9	5.8	3.9	3.8	1.9	1.9	1.9	1.9	-0.7	-0.6
1998	Q4	3.5	3.4	1.7	1.7	1.8	1.7	1.8	1.6	0.2	0.1
1999	Q4	3.3	3.7	1.4	1.9	1.9	1.7	2.2	2.0	0.5	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.

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

January 28, 1998

Item	Units[1]	1991	1992	1993	1994	1995	1996	1997	- - - Projected - - - 1998	1999
EXPENDITURES										
Nominal GDP	Bill. $	5916.7	6244.4	6558.1	6947.0	7265.4	7636.0	8083.4	8421.2	8714.0
Real GDP	Bill. Ch. $	6079.4	6244.4	6389.6	6610.7	6742.1	6928.4	7189.8	7366.2	7492.9
Real GDP	% change	0.4	3.6	2.4	3.3	1.6	3.2	3.8	1.7	1.9
Gross domestic purchases		0.0	4.0	3.0	3.6	1.2	3.6	4.3	2.6	2.3
Final sales		-0.4	3.9	2.1	2.7	2.2	3.1	3.3	2.4	1.8
Priv. dom. final purchases		-0.8	4.9	3.7	3.7	2.5	3.8	4.4	3.9	2.4
Personal cons. expenditures		-0.2	4.2	2.7	3.1	2.2	2.7	3.7	3.5	2.1
Durables		-3.1	9.4	7.4	6.3	3.0	3.9	6.7	5.8	2.7
Nondurables		-1.0	3.4	1.6	3.0	1.0	1.8	1.8	2.9	1.7
Services		0.9	3.6	2.3	2.5	2.7	2.8	4.0	3.4	2.1
Business fixed investment		-6.0	5.5	9.9	7.6	6.5	11.7	9.1	7.7	5.4
Producers' dur. equipment		-2.6	9.6	12.2	10.2	8.3	12.2	12.9	9.2	6.4
Nonres. structures		-12.5	-3.4	4.5	1.1	2.0	10.3	-0.2	3.9	2.9
Residential structures		1.1	16.9	7.8	4.2	-1.9	3.9	5.4	0.6	-0.3
Exports		8.6	4.1	4.6	10.0	10.3	9.3	10.5	0.5	4.1
Imports		4.1	7.4	10.2	12.3	5.6	11.8	14.1	7.9	6.5
Gov't. cons. & investment		-0.7	1.7	-1.4	0.1	-1.4	2.0	1.1	0.6	0.9
Federal		-3.1	1.3	-6.1	-3.9	-6.0	1.5	-0.3	-2.5	-1.8
Defense		-5.3	-1.3	-6.9	-6.0	-5.9	1.1	-1.1	-4.4	-2.1
State & local		1.0	2.0	2.0	2.7	1.4	2.2	2.0	2.4	2.3
Change in bus. inventories	Bill. Ch. $	-3.0	7.0	22.1	60.6	27.3	25.0	63.6	36.2	26.9
Nonfarm		-1.2	2.0	29.5	49.0	35.7	22.5	55.8	30.1	22.3
Net exports		-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-145.0	-218.5	-271.1
Nominal GDP	% change	3.8	6.3	5.0	5.8	4.0	5.6	5.8	3.4	3.7
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	108.3	108.6	110.7	114.1	117.2	119.5	122.3	124.6	125.7
Unemployment rate	%	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.7	5.0
Industrial prod. index	% change	-0.0	3.7	3.3	6.5	3.3	4.2	5.8	0.7	2.2
Capacity util. rate - mfg.	%	77.9	79.4	80.5	82.5	82.8	81.4	81.7	80.5	78.7
Housing starts	Millions	1.01	1.20	1.29	1.46	1.35	1.48	1.48	1.47	1.44
Light motor vehicle sales		12.52	12.85	13.87	15.02	14.73	15.05	15.11	14.88	14.52
North Amer. produced		9.74	10.51	11.71	12.88	12.82	13.34	13.12	13.05	12.79
Other		2.77	2.34	2.15	2.13	1.90	1.71	1.93	1.84	1.73
INCOME AND SAVING										
Nominal GNP	Bill. $	5932.4	6255.5	6576.8	6955.2	7270.6	7637.7	8063.1	8386.1	8669.2
Nominal GNP	% change	3.5	6.2	5.1	5.7	4.1	5.5	5.4	3.2	3.6
Nominal personal income		3.7	7.3	4.2	5.1	5.2	5.8	6.0	3.8	3.8
Real disposable income		0.8	4.0	1.5	2.4	2.4	2.0	3.7	2.5	2.1
Personal saving rate	%	6.0	6.2	5.1	4.2	4.8	4.3	3.8	3.5	3.3
Corp. profits, IVA & CCAdj.	% change	4.5	11.3	19.0	14.1	11.0	9.1	11.2	-3.9	1.1
Profit share of GNP	%	6.9	6.8	7.5	8.2	8.9	9.6	10.0	9.7	9.2
Excluding FR Banks		6.6	6.6	7.2	7.9	8.6	9.3	9.7	9.4	9.0
Federal surpl./deficit	Bill. $	-196.0	-280.9	-250.7	-186.7	-174.4	-110.5	-26.6	-9.4	-17.4
State & local surpl./def.		75.8	86.3	87.4	96.8	103.1	105.3	109.9	119.1	115.6
Ex. social ins. funds		11.5	18.3	19.7	27.9	32.5	34.1	38.5	47.6	44.0
Gross natl. saving rate	%	15.7	14.5	14.4	15.5	16.0	16.6	17.4	17.1	16.5
Net natl. saving rate		4.8	3.7	3.7	4.7	5.5	6.4	7.4	7.1	6.4
PRICES AND COSTS										
GDP chn.-wt. price index	% change	3.3	2.6	2.6	2.5	2.4	2.3	1.9	1.7	1.7
Gross Domestic Purchases chn.-wt. price index		2.7	2.7	2.3	2.5	2.3	2.3	1.4	1.4	1.7
CPI		3.0	3.1	2.7	2.7	2.6	3.2	1.9	1.6	2.0
Ex. food and energy		4.4	3.5	3.1	2.8	3.0	2.6	2.2	2.1	2.0
ECI, hourly compensation[2]		4.4	3.5	3.6	3.1	2.6	3.1	3.4	3.2	3.1
Nonfarm business sector										
Output per hour		2.2	3.5	-0.2	-0.1	0.4	1.2	2.3	0.8	1.5
Compensation per Hour		4.8	4.5	1.8	1.9	2.8	3.3	4.1	3.4	3.2
Unit labor cost		2.5	1.0	2.0	2.0	2.4	2.1	1.7	2.6	1.7

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

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Class II FOMC

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

January 28, 1998

Item	Units	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2
EXPENDITURES											
Nominal GDP	Bill. $	7168.9	7209.5	7301.3	7381.9	7467.5	7607.7	7676.0	7792.9	7933.6	8034.3
Real GDP	Bill. Ch. $	6703.7	6708.8	6759.2	6796.5	6826.4	6926.0	6943.8	7017.4	7101.6	7159.6
Real GDP	% change	0.9	0.3	3.0	2.2	1.8	6.0	1.0	4.3	4.9	3.3
Gross domestic purchases		1.3	0.2	1.9	1.3	3.1	6.5	2.4	2.5	5.9	3.7
Final sales		1.8	1.9	3.3	2.0	2.6	5.2	0.2	4.5	3.0	2.5
Priv. dom. final purchases		2.5	2.2	2.7	2.5	4.4	5.5	2.1	3.2	5.1	2.9
Personal cons. expenditures		1.5	2.9	2.6	1.8	3.1	3.7	0.5	3.3	5.3	0.9
Durables		-3.0	3.9	9.3	2.0	4.8	9.7	-1.9	3.5	14.1	-5.4
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	3.9
Business fixed investment		14.2	5.7	1.6	4.9	11.7	13.0	16.5	5.9	4.1	14.6
Producers' dur. equipment		16.1	6.2	2.0	9.4	13.1	14.9	19.1	2.6	6.7	23.0
Nonres. structures		9.5	4.3	0.7	-5.8	8.2	7.9	10.0	15.3	-2.1	-4.7
Residential structures		-7.0	-15.5	8.4	8.5	8.3	17.9	-4.5	-4.3	3.3	7.4
Exports		7.2	9.3	13.5	11.5	1.7	9.6	1.9	25.5	9.9	18.4
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	3.1
Federal		-1.1	-4.5	-1.3	-16.4	7.5	8.8	-4.2	-5.2	-5.8	6.6
Defense		-1.1	-1.6	-4.0	-15.9	6.1	11.0	-4.6	-7.1	-11.8	7.5
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	77.6
Nonfarm		54.7	34.0	29.6	24.4	14.5	17.3	31.6	26.5	58.3	78.1
Net exports		-113.5	-112.8	-92.9	-76.1	-100.8	-112.6	-138.9	-105.6	-126.3	-136.6
Nominal GDP	% change	4.2	2.3	5.2	4.5	4.7	7.7	3.6	6.2	7.4	5.2
EMPLOYMENT AND PRODUCTION											
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	5.7	5.7	5.6	5.6	5.4	5.3	5.3	5.3	4.9
Industrial prod. index	% change	5.9	1.6	4.5	1.1	2.0	7.5	3.6	3.8	5.2	4.6
Capacity util. rate - mfg.	%	83.8	82.9	82.6	81.8	81.0	81.6	81.5	81.4	81.6	81.5
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
INCOME AND SAVING											
Nominal GNP	Bill. $	7175.1	7220.6	7298.3	7388.5	7475.3	7610.5	7669.1	7796.1	7919.2	8013.6
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	3.1
Personal saving rate	%	5.3	4.6	4.5	4.6	4.7	4.1	4.5	3.9	3.7	4.2
Corp. profits, IVA & CCAdj.	% change	-2.9	10.0	31.7	7.9	20.0	12.1	0.6	4.5	18.1	8.2
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	9.6
Federal surpl./deficit	Bill. $	-191.5	-179.5	-176.5	-150.2	-153.6	-111.6	-99.5	-77.1	-55.5	-36.8
State & local surpl./def.		107.7	105.6	101.1	97.8	104.1	114.4	102.6	100.4	104.7	104.9
Ex. social ins. funds		37.7	35.3	30.3	26.8	33.2	43.1	31.1	28.9	33.5	33.3
Gross natl. saving rate	%	15.8	15.7	16.0	16.6	16.3	16.5	16.9	16.7	16.8	17.4
Net natl. saving rate		5.4	5.1	5.5	6.0	6.0	6.4	6.7	6.6	6.7	7.4
PRICES AND COSTS											
GDP chn.-wt. price index	% change	3.3	2.1	2.0	2.1	2.8	1.9	2.7	1.9	2.4	1.8
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	0.8
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[1]		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	2.4
Compensation per hour		2.6	3.1	2.7	2.9	2.8	4.4	2.9	3.3	4.5	3.3
Unit labor cost		4.2	2.3	1.6	1.3	0.9	2.1	3.9	1.5	3.1	0.9

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

January 28, 1998

Item	Units	1997 Q3	1997 Q4	1998 Q1 (Projected)	1998 Q2 (Projected)	1998 Q3 (Projected)	1998 Q4 (Projected)	1999 Q1 (Projected)	1999 Q2 (Projected)	1999 Q3 (Projected)	1999 Q4 (Projected)
EXPENDITURES											
Nominal GDP	Bill. $	8124.3	8241.5	8330.1	8384.7	8449.3	8520.7	8598.8	8673.1	8751.2	8832.9
Real GDP	Bill. Ch. $	7214.0	7283.9	7331.8	7349.8	7376.4	7407.0	7439.4	7473.7	7510.0	7548.3
Real GDP	% change	3.1	3.9	2.7	1.0	1.5	1.7	1.8	1.9	2.0	2.1
Gross domestic purchases		4.3	3.3	4.0	2.2	2.6	1.6	2.4	2.1	2.7	1.8
Final sales		4.7	3.0	2.8	2.3	1.9	2.6	1.2	1.9	1.4	2.5
Priv. dom. final purchases		7.1	2.7	5.4	3.9	3.6	2.8	2.3	2.3	2.4	2.5
Personal cons. expenditures		5.6	2.9	4.7	3.8	3.2	2.5	2.0	2.0	2.1	2.1
Durables		18.4	1.5	11.8	4.3	4.2	3.2	2.2	2.5	3.0	3.1
Nondurables		4.3	0.3	3.9	3.2	2.6	2.0	1.9	1.7	1.7	1.7
Services		3.9	4.5	3.7	4.0	3.3	2.6	2.0	2.1	2.1	2.1
Business fixed investment		19.2	-0.4	11.7	6.2	7.1	6.0	5.1	5.1	5.5	6.1
Producers' dur. equipment		24.1	-0.3	13.9	7.3	8.6	7.1	6.0	5.9	6.5	7.3
Nonres. structures		6.7	-0.5	6.0	3.4	3.2	3.1	2.9	2.9	2.9	2.9
Residential structures		2.7	8.1	1.7	0.8	0.2	-0.1	-0.4	0.2	-0.8	-0.4
Exports		4.4	9.5	-3.1	0.0	-2.2	7.5	0.9	6.3	0.9	8.5
Imports		14.6	4.1	8.1	10.0	7.7	6.0	6.3	7.9	6.7	5.3
Gov't. cons. & investment		1.1	0.9	-1.1	1.4	1.0	1.1	-0.1	1.5	1.0	1.1
Federal		-1.1	-0.5	-7.2	-0.2	-1.3	-1.1	-4.6	-0.1	-1.3	-1.2
Defense		1.2	-0.2	-12.8	-0.8	-2.5	-1.0	-6.4	0.5	-1.3	-1.3
State & local		2.3	1.7	2.5	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Change in bus. inventories	Bill. Ch. $	47.5	65.5	62.3	38.9	30.5	13.1	24.3	23.6	34.3	25.4
Nonfarm		38.3	56.4	53.8	32.4	25.5	8.7	19.7	19.1	29.7	20.8
Net exports		-164.1	-153.2	-183.4	-211.6	-239.4	-239.4	-256.3	-265.1	-283.7	-279.5
Nominal GDP	% change	4.6	5.9	4.4	2.6	3.1	3.4	3.7	3.5	3.7	3.8
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	122.6	123.5	124.2	124.5	124.8	125.0	125.3	125.5	125.8	126.0
Unemployment rate	%	4.9	4.7	4.6	4.7	4.7	4.8	4.9	5.0	5.1	5.2
Industrial prod. index	% change	6.0	7.4	3.0	-1.2	0.1	1.1	2.1	1.9	2.2	2.5
Capacity util. rate - mfg.	%	81.6	82.2	82.0	80.7	79.9	79.3	79.0	78.7	78.6	78.6
Housing starts	Millions	1.46	1.53	1.48	1.48	1.47	1.46	1.45	1.45	1.43	1.43
Light motor vehicle sales		15.34	15.30	15.14	14.91	14.79	14.70	14.59	14.50	14.49	14.49
North Amer. produced		13.31	13.17	13.20	13.06	12.98	12.94	12.86	12.77	12.76	12.76
Other		2.03	1.94	1.94	1.85	1.81	1.76	1.73	1.73	1.73	1.73
INCOME AND SAVING											
Nominal GNP	Bill. $	8103.5	8216.2	8300.0	8352.3	8412.8	8479.4	8557.4	8629.6	8706.1	8783.8
Nominal GNP	% change	4.6	5.7	4.1	2.5	2.9	3.2	3.7	3.4	3.6	3.6
Nominal personal income		4.6	6.3	4.8	3.4	3.5	3.3	4.6	3.6	3.5	3.5
Real disposable income		2.6	4.6	5.9	1.6	1.3	1.2	4.1	1.4	1.4	1.6
Personal saving rate	%	3.5	3.9	4.2	3.7	3.3	3.0	3.5	3.3	3.2	3.1
Corp. profits, IVA & CCAdj.	% change	17.2	2.2	-1.5	-7.4	-4.8	-1.7	-1.6	1.0	2.6	2.5
Profit share of GNP	%	10.2	10.1	10.0	9.7	9.5	9.4	9.3	9.2	9.2	9.2
Excluding FR Banks		9.9	9.9	9.7	9.5	9.3	9.2	9.0	9.0	9.0	9.0
Federal surpl./deficit	Bill. $	-10.8	-3.1	-11.1	-10.2	-4.9	-11.6	-22.9	-18.6	-11.3	-16.7
State & local surpl./def.		111.4	118.4	120.6	119.2	117.8	118.6	117.2	115.8	114.8	114.4
Ex. social ins. funds		40.0	47.0	49.2	47.7	46.3	47.1	45.6	44.2	43.2	42.8
Gross natl. saving rate	%	17.4	17.7	17.7	17.2	16.9	16.5	16.6	16.5	16.5	16.3
Net natl. saving rate		7.5	7.9	7.9	7.3	6.8	6.4	6.6	6.4	6.4	6.2
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.4	1.9	1.8	1.6	1.6	1.7	1.9	1.6	1.7	1.7
Gross Domestic Purchases chn.-wt. price index		1.3	1.5	0.7	1.4	1.7	1.8	1.9	1.7	1.7	1.6
CPI		2.0	2.3	0.5	1.7	2.1	2.2	2.1	2.0	2.0	2.0
Ex. food and energy		1.7	2.1	2.0	2.0	2.1	2.2	2.0	2.0	2.0	2.0
ECI, hourly compensation[1]		3.4	4.9	3.3	3.2	3.2	3.2	3.0	3.2	3.2	3.2
Nonfarm business sector											
Output per hour		4.1	1.3	0.6	0.4	0.9	1.2	1.3	1.4	1.5	1.6
Compensation per hour		3.9	4.7	3.6	3.4	3.3	3.3	3.2	3.2	3.2	3.2
Unit labor cost		-0.2	3.3	2.9	3.0	2.4	2.1	1.9	1.8	1.7	1.6

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	95Q4/ 94Q4	96Q4/ 95Q4	97Q4/ 96Q4
Real GDP	3.0	2.2	1.8	6.0	1.0	4.3	4.9	3.3	3.1	1.6	3.2	3.8
Gross dom. purchases	1.9	1.3	3.1	6.6	2.4	2.5	6.0	3.7	4.4	1.2	3.6	4.3
Final sales	3.3	1.9	2.6	5.2	0.2	4.5	3.0	2.5	4.7	2.2	3.1	3.3
Priv. dom. final purchases	2.3	2.0	3.6	4.5	1.7	2.7	4.2	2.4	5.8	2.0	3.1	3.6
Personal cons. expenditures	1.8	1.2	2.1	2.5	0.4	2.2	3.6	0.6	3.8	1.5	1.8	2.5
Durables	0.7	0.2	0.4	0.8	-0.2	0.3	1.1	-0.5	1.4	0.2	0.3	0.5
Nondurables	0.1	0.1	0.4	0.5	0.1	0.4	0.9	-0.4	0.8	0.2	0.4	0.4
Services	0.9	0.9	1.4	1.2	0.4	1.5	1.5	1.5	1.5	1.0	1.1	1.6
Business fixed investment	0.2	0.5	1.1	1.3	1.6	0.6	0.4	1.4	1.9	0.6	1.1	0.9
Producers' dur. equip.	0.1	0.6	0.9	1.0	1.3	0.2	0.5	1.6	1.7	0.6	0.9	0.9
Nonres. structures	0.0	-0.2	0.2	0.2	0.3	0.4	-0.1	-0.1	0.2	0.1	0.3	-0.0
Residential structures	0.3	0.3	0.3	0.7	-0.2	-0.2	0.1	0.3	0.1	-0.1	0.2	0.2
Net exports	1.1	1.0	-1.3	-0.6	-1.4	1.8	-1.0	-0.4	-1.3	0.4	-0.4	-0.5
Exports	1.4	1.2	0.2	1.1	0.2	2.7	1.1	2.0	0.5	1.1	1.0	1.2
Imports	-0.2	-0.3	-1.5	-1.7	-1.6	-0.8	-2.1	-2.5	-1.7	-0.7	-1.4	-1.7
Government cons. & invest.	-0.1	-1.0	0.3	1.3	-0.2	0.0	-0.1	0.6	0.2	-0.3	0.4	0.2
Federal	-0.1	-1.2	0.5	0.6	-0.3	-0.4	-0.4	0.4	-0.1	-0.4	0.1	-0.0
Defense	-0.2	-0.8	0.3	0.5	-0.2	-0.3	-0.6	0.3	0.1	-0.3	0.0	-0.0
Nondefense	0.1	-0.4	0.2	0.1	-0.1	0.0	0.2	0.1	-0.1	-0.2	0.1	0.0
State and local	0.0	0.2	-0.2	0.7	0.1	0.4	0.3	0.1	0.3	0.2	0.3	0.2
Change in bus. inventories	-0.2	0.3	-0.8	0.7	0.8	-0.2	1.8	0.8	-1.6	-0.6	0.1	0.4
Nonfarm	-0.2	-0.3	-0.6	0.1	0.8	-0.2	1.8	0.7	-1.7	-0.5	0.0	0.4
Farm	0.0	0.6	-0.2	0.5	0.1	-0.1	0.0	0.1	0.1	-0.1	0.1	0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

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	3.9	2.7	1.0	1.5	1.7	1.8	1.9	2.0	2.1	3.8	1.7	1.9
Gross dom. purchases	3.4	4.1	2.2	2.7	1.6	2.5	2.2	2.7	1.8	4.3	2.6	2.3
Final sales	3.0	2.8	2.2	1.9	2.6	1.2	1.9	1.4	2.5	3.3	2.4	1.7
Priv. dom. final purchases	2.2	4.4	3.2	3.0	2.3	1.9	2.0	2.0	2.1	3.6	3.2	2.0
Personal cons. expenditures	2.0	3.2	2.5	2.2	1.7	1.4	1.4	1.4	1.4	2.5	2.4	1.4
Durables	0.1	0.9	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.5	0.5	0.2
Nondurables	0.1	0.7	0.6	0.5	0.4	0.4	0.3	0.3	0.3	0.4	0.6	0.3
Services	1.8	1.5	1.6	1.4	1.0	0.8	0.9	0.9	0.9	1.6	1.4	0.9
Business fixed investment	-0.0	1.2	0.6	0.7	0.6	0.5	0.5	0.6	0.6	0.9	0.8	0.6
Producers' dur. equip.	-0.0	1.0	0.6	0.7	0.5	0.5	0.5	0.5	0.6	0.9	0.7	0.5
Nonres. structures	-0.0	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	-0.0	0.1	0.1
Residential structures	0.3	0.1	0.0	0.0	-0.0	-0.0	0.0	-0.0	-0.0	0.2	0.0	-0.0
Net exports	0.6	-1.4	-1.2	-1.2	0.1	-0.7	-0.3	-0.8	0.2	-0.5	-0.9	-0.4
Exports	1.1	-0.4	0.0	-0.3	0.8	0.1	0.7	0.1	0.9	1.2	0.1	0.5
Imports	-0.5	-1.0	-1.2	-1.0	-0.8	-0.8	-1.0	-0.9	-0.7	-1.7	-1.0	-0.8
Government cons. & invest.	0.2	-0.2	0.3	0.2	0.2	-0.0	0.3	0.2	0.2	0.2	0.1	0.2
Federal	-0.0	-0.5	-0.0	-0.1	-0.1	-0.3	-0.0	-0.1	-0.1	-0.0	-0.2	-0.1
Defense	-0.0	-0.6	-0.0	-0.1	-0.0	-0.3	0.0	-0.1	-0.1	-0.0	-0.2	-0.1
Nondefense	-0.0	0.1	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0	0.0	0.0	-0.0
State and local	0.2	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	0.9	-0.2	-1.2	-0.4	-0.9	0.6	-0.0	0.6	-0.5	0.4	-0.7	0.2
Nonfarm	1.0	-0.1	-1.1	-0.4	-0.9	0.6	-0.0	0.6	-0.5	0.4	-0.6	0.2
Farm	-0.0	-0.0	-0.1	-0.1	-0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0

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

Strictly Confidential (FR)
Class II FOMC

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

January 28, 1998

Item	Fiscal year[5]				1997				1998				1999			
	1996[a]	1997[a]	1998	1999	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1453	1579	1671	1719	349	496	387	386	371	517	397	397	372	529	421	399
Outlays[1]	1560	1601	1672	1718	401	396	398	426	415	413	417	464	399	425	430	442
Surplus/deficit[1]	-107	-22	0	1	-52	100	-11	-40	-45	104	-20	-67	-27	104	-9	-43
On-budget	*-174*	*-103*	*-92*	*-108*	*-69*	*61*	*-19*	*-66*	*-58*	*59*	*-26*	*-66*	-75	53	-20	-76
Off-budget	67	81	91	109	17	39	8	26	14	45	7	-1	48	51	11	33
Surplus excluding deposit insurance[2]	-116	-36	-5	-3	-56	97	-12	-41	-46	102	-21	-68	-28	103	-10	-44
Means of financing																
Borrowing	130	38	28	14	48	-69	11	34	43	-82	33	33	41	-85	25	28
Cash decrease	-6	1	4	0	-1	-18	8	12	12	-17	-3	20	0	-15	-5	10
Other[3]	-16	-17	-32	-15	5	-13	-7	-6	-11	-4	-11	13	-14	-4	-10	5
Cash operating balance, end of period	44	44	40	40	33	51	44	32	20	37	40	20	20	35	40	30
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1550	1692	1779	1813	1675	1709	1742	1772	1770	1779	1792	1802	1801	1816	1832	1846
Expenditures	1679	1737	1786	1829	1731	1746	1753	1776	1781	1790	1797	1814	1824	1834	1843	1862
Consumption expend.	447	460	465	469	458	464	465	464	464	466	466	467	469	470	471	471
Defense	302	309	308	308	306	311	312	310	307	307	307	307	307	308	308	308
Nondefense	145	151	157	162	152	153	153	154	157	158	160	160	162	162	162	162
Other expenditures	1232	1277	1321	1360	1273	1282	1288	1312	1317	1324	1330	1347	1355	1364	1373	1392
Current account surplus	-129	-45	-7	-16	-56	-37	-11	-3	-11	-10	-5	-12	-23	-19	-11	-17
Gross investment	69	61	60	58	58	62	61	65	59	59	59	59	57	58	58	58
Current and capital account surplus	-197	-106	-68	-74	-114	-99	-72	-68	-70	-69	-64	-70	-80	-76	-69	-74
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-220	-167	-157	-144	-170	-167	-149	-158	-164	-158	-148	-149	-152	-143	-132	-133
Change in HEB, percent of potential GDP	-.6	-.7	-.1	-.2	-.2	0	-.2	.1	.1	-.1	-.1	0	0	-.1	-.1	0
Fiscal impetus (FI), percent, cal. year	-2.3	-1.7	-1.8	-1.3	-1.1	1.5	.2	-.9	-.8	-.3	-.4	-1.4	.8	-.3	-.6	-1.1

1. OMB's September 1997 deficit estimates (assuming the enactment of the President's proposals) are $58 billion in FY98 and $57 billion in FY99. CBO's January 1998 baseline deficit estimates are $5 billion in FY98 and $2 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 $63 billion in FY98 and $59 billion in FY99. CBO's January 1998 baseline deficit estimates, excluding deposit insurance, are $11 billion in FY98 and $6 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 associated with an unemployment rate of 6 percent. Real potential GDP growth is assumed to rise from 2.2 percent in 1996 to 2.5 percent in 1999, reflecting CPI modifications. 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.

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

Period [1]	Total [2]	Federal government [3]	Nonfederal						Memo:
				Households					
			Total [4]	Total	Home mortgages	Consumer credit	Business	State and local governments	Nominal GDP
Year									
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	1.5	3.3	5.1	4.4
1991	4.3	11.1	2.3	5.0	6.6	-1.3	-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	7.6	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	5.9	14.1	6.2	-3.8	4.0
1996	5.2	4.0	5.7	7.6	8.1	7.9	4.6	1.2	5.6
1997	4.8	0.6	6.2	6.2	7.1	4.7	6.4	5.7	5.8
1998	5.2	0.7	6.7	6.6	7.6	4.5	7.3	5.1	3.4
1999	4.6	0.2	6.0	5.8	6.9	3.2	6.6	5.1	3.7
Quarter									
1997:3	4.7	1.1	5.9	5.5	7.2	3.4	6.8	4.6	4.6
4	5.3	1.8	6.5	6.5	7.4	4.8	6.4	6.9	5.9
1998:1	5.3	1.5	6.6	6.5	7.5	4.7	7.1	5.0	4.4
2	4.0	-3.6	6.6	6.4	7.4	4.5	7.1	5.0	2.6
3	5.8	3.4	6.5	6.4	7.3	4.4	7.1	5.0	3.1
4	5.3	1.6	6.5	6.4	7.3	4.1	6.9	5.0	3.4
1999:1	5.0	1.2	6.1	6.0	7.1	3.8	6.6	5.1	3.7
2	3.6	-3.8	6.0	5.7	6.8	3.3	6.5	5.1	3.5
3	5.0	2.5	5.8	5.5	6.6	2.9	6.4	5.0	3.7
4	4.6	1.1	5.7	5.4	6.5	2.6	6.3	4.9	3.8

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 1997:Q3 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 4.6 percent in 1997, 5.2 percent in 1998, and 4.8 percent in 1999.

3. On a monthly average basis, federal debt rose 0.6 percent in 1997, 0.8 percent in 1998, and .5 percent in 1999.

4. On a monthly average basis, nonfederal debt increased 6.0 percent in 1997, 6.7 percent in 1998, and 6.1 percent in 1999.

2.6.3 FOF

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

Category	Calendar year				Seasonally adjusted annual rates									
					1997		1998				1999			
	1996	1997	1998	1999	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	658.9	612.6	678.2	644.9	637.8	705.9	709.5	503.2	776.3	723.9	685.3	482.5	729.0	682.8
2 Net equity issuance	-64.2	-79.9	-114.1	-98.6	-60.4	-90.0	-100.4	-120.4	-121.2	-114.4	-107.6	-106.8	-94.0	-86.0
3 Net debt issuance	723.1	692.5	792.3	743.5	698.2	795.9	809.9	623.6	897.5	838.3	792.9	589.3	823.0	768.8
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	7.6	46.4	76.0	111.5	24.6	45.5	78.7	73.3	78.7	73.1	102.0	105.7	121.3	116.9
5 Net equity issuance	-64.2	-79.9	-114.1	-98.6	-60.4	-90.0	-100.4	-120.4	-121.2	-114.4	-107.6	-106.8	-94.0	-86.0
6 Credit market borrowing	193.7	281.0	338.5	329.1	308.4	292.9	333.5	338.0	342.4	340.1	328.1	328.1	330.1	330.1
Households														
7 Net borrowing [2]	371.8	326.3	367.6	343.6	297.5	357.9	363.6	363.8	367.0	376.0	357.6	346.6	336.6	333.6
8 Home mortgages	273.0	254.5	292.5	287.2	267.8	280.8	288.4	291.9	291.8	297.9	293.4	288.4	283.4	283.4
9 Consumer credit	88.8	57.4	57.0	42.3	42.7	59.6	59.1	58.0	56.5	54.3	50.0	44.0	39.0	36.0
10 Debt/DPI (percent) [3]	90.7	92.1	93.6	95.6	92.4	92.5	92.5	93.3	94.0	94.7	94.8	95.4	96.0	96.4
State and local governments														
11 Net borrowing	12.7	62.1	58.4	61.9	51.3	77.8	56.9	57.9	58.9	59.9	61.9	61.9	61.9	61.9
12 Current surplus [4]	126.1	109.8	129.1	124.8	117.5	121.1	131.1	129.4	127.8	128.4	126.7	125.1	123.9	123.3
Federal government														
13 Net borrowing	145.0	23.1	27.9	9.0	40.9	67.3	56.0	-136.0	129.3	62.4	45.4	-147.2	94.5	43.3
14 Net borrowing (quarterly, n.s.a.)	145.0	23.1	27.9	9.0	10.6	33.7	43.4	-82.2	33.5	33.1	40.8	-85.0	24.8	28.3
15 Unified deficit (quarterly, n.s.a.)	110.9	2.4	27.2	-24.7	10.9	39.7	44.6	-103.5	19.5	66.6	26.8	-104.2	9.3	43.3
Depository institutions														
16 Funds supplied	233.2	285.1	284.7	273.9	177.9	282.7	317.7	274.7	259.5	286.9	273.9	273.9	273.9	273.9
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	185.3	183.8	185.3	187.8	183.6	183.3	183.7	184.7	185.5	186.5	187.2	187.6	187.9	188.4
18 Domestic nonfinancial borrowing	9.5	8.6	9.4	8.5	8.6	9.7	9.7	7.4	10.6	9.8	9.2	6.8	9.4	8.7
19 Federal government [6]	1.9	0.3	0.3	0.1	0.5	0.8	0.7	-1.6	1.5	0.7	0.5	-1.7	1.1	0.5
20 Nonfederal	7.6	8.3	9.1	8.4	8.1	8.8	9.1	9.1	9.1	9.1	8.7	8.5	8.3	8.2

Note. Data after 1997:Q3 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.

2.6.4 FOF

International Developments

Recent Developments

Global financial markets remained in turmoil during the intermeeting period. Although the situation in Korea worsened after the December FOMC meeting, emergency actions by the IMF and Korea's creditors in late December mitigated the external financing crisis and helped to stabilize won exchange rates. Severe turbulence erupted in Indonesian financial markets at the turn of the year. Over the intermeeting period, the dollar moved down against the yen and appreciated somewhat relative to the mark; it appreciated against the currencies of developing economies on balance.

Since the December FOMC meeting, the dollar has depreciated more than 4 percent against the yen. Despite government measures proposed in mid-December and sizable sales of dollars by Japanese authorities to support the yen, the dollar moved up through early January, as a result of concerns about the weak Japanese economy and the bankruptcy of a large commercial concern. With rumors of additional fiscal stimulus in Japan, the dollar has reversed course since early January. It rose against the mark through much of the intermeeting period but retreated sharply late in the period and returned to about its level at the time of the December FOMC. Its initial rise appeared to reflect the growing awareness of market participants that the crisis in Asia would have a greater impact on European economies than had been thought. Its subsequent decline reflected both evidence of further strength in the German economy.

. News of the scandal that has rocked the Clinton Administration weighed on the dollar.

The dollar has appreciated against Asian currencies since the December FOMC meeting. Early in the period, the Korean won fell precipitously, first following the removal of daily limits on currency fluctuations and later amid rating agency downgrades and revelations about the magnitude of Korea's short-term foreign-currency obligations. The won stabilized in late December following a strengthening of the IMF program, announcements of accelerated disbursements from international organizations and the possibility of official bilateral support, and a decision by creditors to roll over short-term obligations. On balance, the won has lost more than 6-1/2 percent against the dollar since the December FOMC meeting, bringing the decline since the beginning of October to 45 percent. The Indonesian rupiah plunged in early January following the release of the government's 1998 budget, which was viewed as inconsistent with targets laid out in Indonesia's program with the IMF and reinforced concerns about political will to implement meaningful reforms. Despite meetings in mid-January of Indonesian, IMF, and U.S. officials that resulted in the announcement of accelerated reforms and substantial restructuring, the rupiah plummeted further. Announcements this week of frameworks for restructuring the banking system and corporations' foreign debts have had an initial favorable effect on financial markets. On balance, the rupiah ended the period down 48 percent against the dollar since the December FOMC meeting and 69 percent since the beginning of October. Both the Malaysian ringgit and the Thai baht fell 11 percent over the intermeeting period.

Stock markets generally moved higher in industrial countries over the intermeeting period. After dropping 7-3/4 percent early in the period, Japanese stock prices turned up as the rumors of additional fiscal stimulus began to surface; equity prices ended the period up 6-3/4 percent. European stock price increases ranged from 2 percent in the United Kingdom to more than 18 percent in Italy. Despite declining exchange rates, stock prices in several Asian economies rose; prices fell in Hong Kong following the liquidation of Peregrine Investments.

Three-month interest rates fell in most major foreign industrial countries since the December FOMC meeting, with declines ranging from about 10 basis points in Japan and France to about 30 basis points in some other continental European countries. The Bank of Italy trimmed its official rate by 75 basis points in late December, a move that was widely anticipated by market participants. With the exception of Japan, yields on ten-year securities generally have dropped a bit more than short-term rates have. In Japan, the long-term yield rose 18 basis points over the period.

. The Desk did not intervene.

The economic expansion appears to have continued at a healthy clip in the final quarter of 1997 in all of the foreign G-7 countries except Japan. In Germany, industrial production showed strong gains in October and November, although a sharp drop in export orders may signal that the crises in Asia have begun to affect European producers. The rate of economic expansion slowed a bit further in the United Kingdom during the fourth quarter, to 2.1 percent (annual rate). However, the data likely exaggerate the extent to which U.K. growth slowed in the fourth quarter because unseasonably warm weather led to a substantial drop in utilities production. In Canada, real GDP expanded at an annual rate of more than 4 percent in the third quarter with strong industrial production in October supporting fourth-quarter growth. The weakness of activity in Japan persisted into the fourth quarter, as both production and spending indicators were down from their third-quarter levels, and housing starts remained near ten-year lows. Japan's trade surplus surged during the fourth quarter, despite sizable declines in exports to Korea and Thailand.

Consumer price inflation remains quiescent in all of the foreign G-7 countries except the United Kingdom. In France, Germany, and Italy, year-on-year price increases recently have been near 1-1/2 percent, while in Canada, inflation remains a touch below 1 percent. Abstracting from the effects of tax increases, inflation in Japan is about zero. However, in the United Kingdom, increases in retail prices excluding mortgage interest payments have been about 2-3/4 percent, somewhat above the government's target of 2-1/2 percent.

The financial crises in Asia have begun to show clear signs of affecting output and external imbalances in a number of developing countries in that region. In Korea, the rate of industrial production fell markedly in November and December while the current account swung sharply into surplus. Output continued to decline in Thailand, and tentative evidence for Malaysia, Indonesia, and the Philippines suggests a slowing in the pace of activity. Inflation picked up somewhat during the fourth quarter in many Asian developing countries as the sizable depreciation of exchange rates was passed through to domestic prices. China remained insulated from the financial crises, although the pace of output growth in 1997, at 8.8 percent, was the lowest since 1991. Growth in Latin American countries appears to have continued at a brisk pace into the fourth quarter except in Brazil, where output plunged in November following a substantial increase in interest rates that was necessary to stem exchange market pressures.

The nominal U.S. deficit in trade of goods and services narrowed substantially in October-November from its third-quarter average, falling back to the deficit recorded in the second quarter. Exports grew briskly, with sizable increases in automotive and agricultural products. Although clear evidence of the Asian crises has yet to surface in the U.S. trade data, a sharp decline in exports of computers and semiconductors in November may portend a broader softness over the months ahead. Imports were about unchanged from their level in the third quarter, as increases in imported consumer goods and other machinery were offset by declines in other categories.

The price of imported oil has fallen significantly since early November owing to a number of factors. Spot WTI prices declined in December to an average $18.32

per barrel in the anticipation of increased OPEC production. An additional decline in January, to below $16 per barrel by mid-month, resulted from weakening demand in Asia, relatively mild winter weather in the northeastern United States, and the resumption of oil production for export by Iraq. More recently, saber rattling directed at Iraq has put upward pressure on prices. Non-oil import prices declined 2-1/4 percent (annual rate) in the fourth quarter, continuing a downward trend that began in late 1995. Prices moved lower in all major end-use categories, with the exception of automotive products. Export prices dropped back nearly 3 percent (annual rate) in the fourth quarter, led by falling prices of agricultural products, industrial supplies, computers, and semiconductors.

Outlook

We estimate that growth of total foreign real GDP (weighted by shares in U.S. nonagricultural exports) slowed sharply to just less than 2 percent in the fourth quarter of 1997. Foreign output growth is projected to remain around 2 percent this year, recovering to nearly 3 percent in 1999. The projected pace of foreign growth is lower than it was in the December forecast (see table below) owing to the worsening of the crises in Asia and the implications for output in third countries.

The dollar is projected to remain near recent levels in terms of the currencies of most of our industrial- and developing-country trading partners. Relative to the December Greenbook, the level of the dollar, reflecting its recent appreciation, is higher throughout the forecast period.

In light of the changes to our outlook for foreign growth and for exchange rates, we have reduced the rate of real export growth from that projected in the December forecast. Real imports are also expected to increase less rapidly. We estimate that real net exports added a bit more than 1/2 percentage point to growth in the fourth quarter of last year, a significant change from the negative contribution of 1/2 percentage point we expected in December. In 1998 and 1999, real net exports are projected to subtract nearly 1 percentage point and about 1/3 percentage point, respectively, from GDP growth, the same amount as in the previous Greenbook.

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

Measure	1997			1998	1999
	H1	Q3	Q4		
Foreign output	4.4	4.6	1.9	2.1	2.9
December	4.2	4.8	3.0	2.5	3.2
September	3.8	4.0	4.1	3.9	3.7
Real exports	14.1	4.4	9.5	0.5	4.1
December	14.1	4.7	9.3	3.8	5.8
September	14.9	4.9	14.7	7.6	6.1
Real imports	19.2	14.6	4.1	7.9	6.5
December	19.2	13.9	11.6	10.5	7.8
September	19.2	12.0	9.6	9.2	7.0

The dollar. On balance, the average real value of the dollar, weighted by shares in non-oil imports and measured relative to the currencies of a broad set of our trading partners, is projected to decline 3-1/4 percent over the forecast period from its current level. This projected path for the dollar is about 3-1/4 percent higher than in December, reflecting movements over the intermeeting period. We expect the dollar to decline somewhat against the yen as concern grows about the magnitude of Japan's external surplus. It is also expected to decline against the Canadian dollar, as a slight additional policy tightening returns that currency to the middle of its recent trading range. The dollar is projected to remain near current levels against the mark and other continental European currencies. Against other key Asian currencies, the dollar is forecast to remain at current--substantially appreciated--levels in nominal terms, but inflation in these Asian countries is expected to erode some of the dollar's appreciation in real terms over the projection period.

Foreign G-7 countries. Real GDP in the foreign G-7 countries, weighted by shares in U.S. nonagricultural exports, is expected to slow from 2-3/4 percent (annual rate) on average in the fourth quarter of 1997 to 2-1/4 percent this year and in 1999. A slower pace of activity in the fourth quarter than was projected in the December Greenbook reflects weaker-than-expected data for the United Kingdom and a significant weakening in the growth estimate for Japan. Growth during 1998 is a touch lower in this forecast than it was in the December Greenbook, owing to the effects on the foreign G-7 countries of additional mark-downs in the outlook for Asian developing countries.

Japanese GDP is expected to expand only 1-1/4 percent this year and 1-1/2 percent in 1999. We continue to expect that Japan's exports to its Asian trading partners will be reduced significantly by the ongoing crises, and stresses within the Japanese financial sector and sagging confidence will restrain the growth of private domestic demand. Although announced budget measures suggest that fiscal policy will exert a slight drag on activity in 1998, we continue to assume that additional actions will be taken that will result in a neutral fiscal stance this year.

Real GDP growth in Germany is anticipated to slow to below 2-1/4 percent this year and to rebound to nearly 3 percent in 1999. The contribution of domestic demand is projected to rise as investment spending continues to be spurred by stimulative monetary conditions, whereas the contribution of net exports tapers off. We again expect a significant slowing in the pace of activity in the United Kingdom and Canada over the next two years in part because of past and prospective contractionary policy moves.

Average consumer price inflation in the foreign G-7 countries (weighted by shares in U.S. bilateral imports) is projected to decline to 1-1/4 percent in 1998-99, the same rate that was recorded in 1996. This drop in inflation is entirely accounted for by a return to zero measured inflation in Japan as the effect of the excise tax increase in April 1997 disappears from twelve-month calculations of price change, import prices fall, and the economy remains sluggish.

Our forecast incorporates the assumption that short-term market interest rates in Germany, France, and most other continental European countries will edge down slightly further over the course of 1998. Although market expectations regarding the magnitude of the expected increase in short-term German interest rates have diminished since mid-December, market participants continue to assume that the Bundesbank will raise official interest rates slightly over the near term. In contrast, we assume that the Bundesbank will hold official rates unchanged in 1998 and that short-term interest rates in those European countries headed for monetary union will converge to the current level of German rates by year-end. We expect this process of interest rate convergence to result in a further decline in Italian short-term rates of more than 250 basis points this year. In 1999, short-term interest rates in euro-area countries are expected to rise about 1/2 percentage point as the European Central Bank responds to some firming of growth. Short-term interest rates in Canada are projected to increase slightly over the forecast period as monetary policy is tightened further. Rates in Japan are assumed to remain near current very low levels. With economic slack diminishing in the foreign G-7 over the forecast period, we anticipate a slight increase in long-term interest rates.

Other countries. The real GDP of major developing-country trading partners of the United States (weighted by U.S. bilateral export shares) is projected to increase about 1-1/2 percent on average during 1998, a reduction of 1 percentage point from our forecast in the December Greenbook and about 4 percentage points from the September Greenbook. This downward revision reflects mainly a further marking down of our forecasts for Asian countries. Our view is that the intensification of the financial crises in these countries, along with the depreciation of their currencies and the tightening of macroeconomic policies in some cases, will exert a substantial drag on domestic demand this year. The magnitude of the downward revision since December has been largest for Korea and Indonesia, where the expected rate of GDP growth in each country this year has been cut about 3 percentage points. Growth forecasts for most of the other Asian economies have also been reduced, but by lesser amounts. We project that growth in these countries will recover in most cases next year, but only to substantially below-trend rates. We have revised our inflation forecasts up for the Asian countries to reflect the substantial depreciation of their currencies over the past month.

Our forecast for output growth in Latin America in 1998 has been marked down somewhat, mainly because of a reduction in the outlook for Brazil, where interest rates have been raised sharply to defend the currency. Real GDP in Mexico is still expected to grow at a rate of about a 4-1/2 percent this year and in 1999.

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

Trade category	1997: H1	Projection			
		1997		1998	1999
		Q3	Q4		
Exports					
Nonagricultural (core)	.9	.9	-.9	-1.0	1.3
Agricultural	.1	-6.7	-1.6	-2.9	.8
Imports					
Non-oil (core)	-1.3	.2	-4.1	-1.5	1.1
Oil (level, dollars per barrel)	18.00	17.58	17.61	14.39	16.00

NOTE. Prices for exports and non-oil imports of goods, excluding computers and semiconductors, are on a NIPA chain-weighted basis.
The price of imported oil for multiquarter periods is the price for the final quarter of the period.

Oil prices. We have lowered our forecast for the price of imported oil over the near term a bit more than $1 per barrel since the December Greenbook. We expect import prices to average about $14.25 per barrel during the first quarter of this year owing to the increase in production of 0.75 mb/d by Saudi Arabia, Kuwait, and the United Arab Emirates that began earlier this month. After declining somewhat through the middle of 1998, spot and import prices should rise to $18.50/b and $16.00/b, respectively, by the end of 1999.

We see a relatively weak oil market in 1998--an unexpectedly large increase in OPEC production that may well crowd out at least half of the planned 1.0 mb/d increase in non-OPEC production--but we still see it beginning to tighten during 1999. Absent any further surprises from OPEC, the market will tighten because non-OPEC producers are having difficulty bringing new fields that are under development into production within their planned time frame.

The step-up in oil production since the beginning of this year may contribute to greater volatility in oil prices over the forecast period. The 0.75 mb/d increase in production reduces industry excess capacity by nearly one-third, limiting the ability of the three Persian Gulf producers to increase output over the short run to offset possible supply shocks to the market from other regions.

Prices of non-oil imports and exports. Prices of non-oil imports of core goods are projected to decline through the second quarter of this year before reversing course and increasing slowly through the end of next year. The path for non-oil import prices reflects the leveling out of the dollar's exchange value and the waning of the lagged effects of declines in non-oil commodity prices. Relative to the December Greenbook, core import prices are projected to decline somewhat less rapidly despite the stronger dollar. This adjustment reflects our reassessment of the empirical relationship between exchange rates--particularly for currencies of developing countries--and U.S. non-oil import prices.[1] Prices of core exports of nonagricultural goods are forecast to decline somewhat over the near term and to rise slowly thereafter, in line with comparable U.S. domestic prices.

Real exports and imports of goods and services. We project that exports of nonagricultural goods other than computers and semiconductors ("core" exports) will decline 1-3/4 percent this year and expand 1 percent in 1999. This represents a significant slowing from the estimated 16 percent annual rate increase in the fourth quarter and the 12 percent rise over the four quarters of 1997. The lagged effects of the dollar's appreciation and lower foreign growth over the forecast period than in 1997 account for much of the projected deceleration in core exports.[2] The pace of export growth in 1998 is lower in this forecast than in the December Greenbook because of the intensification of the crises in Asia, its direct effects on the demand for U.S. exports, and its spillover to income growth in our other trading partners. Exports of computers and semiconductors are projected to grow rapidly in real terms but at a pace that is somewhat slower than in the December Greenbook. Putting all the pieces together, the growth of total exports of goods and services is expected to slow to 1/2 percent this year and to pick up to 4 percent in 1999.

Growth of non-oil imports of goods and services other than computers and semiconductors ("core" imports) is projected to decline from about 7-1/2 percent in the fourth quarter of 1997 (annual rate) and in 1998 to 5 percent in 1999. This path reflects the projected slowing of the U.S. economy and the lagged effects of dollar appreciation. Relative to the December Greenbook, core import growth is somewhat weaker in 1998 because non-oil import prices are projected to decline somewhat less

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1. In a reexamination of the equation for core non-oil import prices, we have estimated two separate terms for exchange rate effects. We now distinguish changes in developing country currencies from changes in industrial country currencies. In the new equation, non-oil import prices are less sensitive to changes in developing country currencies than in the old equation, which treated all currencies symmetrically. For this reason, we have changed our view about the magnitude of the passthrough to non-oil import prices of the dollar's appreciation against the currencies of Asian developing countries.

2. The swing in the growth rate of core exports is greater than the swing projected by a model that incorporates the influence of foreign GDP and relative prices. We expect that much of the unexpectedly rapid growth of exports that materialized in the first half of last year will not be repeated this year.

than in the previous forecast. Rapid projected growth for real imports of computers and semiconductors and a strong pick-up in oil imports over the near term result in an anticipated slowing in the growth of total imports of goods and services to 8 percent this year and 6-1/2 percent in 1999. We expect the quantity of imported oil, after declining slightly in the current quarter, to rise over the forecast period in line with increases in consumption. We have increased the level of our forecast path for oil imports roughly 0.1 mb/d because of the shift down in the projected path of oil prices. We expect U.S. oil production to decline slightly in 1998, rather than to increase as we had previously projected, as lower oil prices reduce onshore production in the lower-forty-eight states. Lower oil prices should lead to a decline in liftings in 1999 as well.

Nominal trade and current account balances. The nominal trade deficit on goods and services is expected to deteriorate from $120 billion in the third quarter of 1997 to nearly $190 billion by the end of 1999. Over this period, the deficit on net investment income is projected to increase by $30 billion. As a result, we project that the current account deficit will widen from $170 billion in the third quarter of last year to an average of $260 billion, or 3 percent of GDP, in 1999.

January 28, 1998

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
REAL GDP									
Canada	-0.3	0.9	3.1	4.5	0.8	2.0	4.3	3.0	2.6
Japan	2.5	0.1	0.5	0.8	2.4	3.4	0.3	1.3	1.5
United Kingdom	-1.6	0.4	2.7	4.9	2.0	3.0	3.1	1.7	1.9
EU-11 Average (1)	2.1	0.1	-0.1	3.5	1.4	2.0	2.9	2.5	2.9
of which:									
France	1.4	-0.0	-0.7	4.3	0.3	2.3	2.9	2.1	2.5
Germany (2)	3.3	0.9	-0.2	3.4	0.7	2.1	2.8	2.1	2.9
Italy	1.9	-0.8	0.1	2.7	2.4	0.2	2.3	1.9	2.9
Foreign G-7 Average weighted by 1991 GDP	1.7	0.2	0.6	2.8	1.6	2.4	2.1	1.8	2.2
Average weighted by share of U.S. nonagricultural exports									
Total foreign	3.2	2.2	3.6	5.2	1.8	4.2	3.7	2.1	2.9
Foreign G-7	0.8	0.5	1.9	3.7	1.3	2.4	3.0	2.3	2.3
Developing Countries	6.6	5.2	6.3	7.1	2.7	6.8	5.0	1.5	3.6
CONSUMER PRICES									
Canada	4.1	1.8	1.8	0.0	2.1	2.0	1.0	1.6	1.8
Japan	3.2	0.9	1.2	0.8	-0.8	0.1	2.0	-0.0	0.0
United Kingdom (3)	5.7	3.7	2.7	2.2	2.9	3.2	2.8	2.8	2.9
EU-11 Average (4)	NA	NA	NA	NA	2.7	2.0	1.4	2.1	2.1
of which:									
France	3.0	1.8	2.1	1.6	1.9	1.7	1.2	1.5	1.6
Germany (2)	4.0	3.4	4.2	2.6	1.7	1.4	1.8	2.5	2.1
Italy	6.1	4.9	4.1	3.8	5.9	2.7	1.6	2.1	2.5
Foreign G-7 Average weighted by 1991 GDP	4.1	2.4	2.5	1.8	1.6	1.5	1.8	1.4	1.5
Average weighted by share of U.S. non-oil imports	3.9	1.9	2.0	1.0	1.1	1.3	1.7	1.2	1.2

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.

Strictly Confidential (FR) January 28, 1998
Class II FOMC

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

				Projected								
	1997				1998				1999			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP												
Canada	4.1	5.4	4.1	3.5	2.9	3.2	2.9	2.9	2.6	2.7	2.6	2.6
Japan	8.3	-10.6	3.1	1.5	2.3	1.2	1.0	0.8	0.8	1.7	1.7	1.7
United Kingdom	2.7	4.3	3.4	2.1	2.5	1.5	1.4	1.4	1.7	1.8	2.0	2.0
EU-11 Average (1)	1.3	5.0	2.8	2.4	2.4	2.4	2.6	2.6	2.8	2.8	3.0	3.0
of which:												
France	1.3	4.4	3.5	2.5	1.9	2.0	2.2	2.1	2.4	2.5	2.6	2.6
Germany	1.2	4.1	3.2	2.7	2.0	2.1	2.2	2.3	2.8	2.8	3.0	2.9
Italy	-0.8	7.6	1.8	1.0	1.8	1.8	2.0	2.0	2.5	2.5	3.3	3.3
Foreign G-7 Average weighted by 1991 GDP	3.6	-0.4	3.1	2.0	2.2	1.7	1.7	1.7	1.9	2.2	2.4	2.4
Average weighted by share of U.S. nonagricultural exports												
Total foreign	3.8	4.8	4.6	1.8	2.0	2.0	2.0	2.3	2.5	2.8	3.0	3.1
Foreign G-7	4.3	1.5	3.6	2.7	2.6	2.4	2.2	2.2	2.1	2.4	2.4	2.4
Developing Countries	4.1	8.3	6.4	1.4	0.8	1.3	1.5	2.3	3.0	3.4	3.8	4.2
CONSUMER PRICES (2)												
Canada	2.1	1.6	1.7	1.0	1.3	1.4	1.5	1.6	1.7	1.7	1.8	1.8
Japan	0.0	1.5	1.7	2.0	2.0	0.5	0.0	-0.0	0.0	0.0	0.0	0.0
United Kingdom (3)	2.9	2.6	2.8	2.8	2.7	2.7	2.8	2.8	2.9	3.0	3.0	2.9
EU-11 Average (4)	1.7	1.2	1.5	1.4	1.7	1.9	2.0	2.1	2.1	2.0	2.1	2.1
of which:												
France	1.5	0.9	1.3	1.2	1.2	1.2	1.3	1.5	1.6	1.6	1.6	1.6
Germany	1.7	1.6	1.9	1.8	1.9	2.2	2.5	2.5	2.5	2.1	2.1	2.1
Italy	2.4	1.6	1.5	1.6	2.0	2.0	2.1	2.1	2.3	2.3	2.5	2.5
Foreign G-7 Average weighted by 1991 GDP	1.4	1.6	1.8	1.8	1.9	1.5	1.4	1.4	1.5	1.4	1.5	1.5
Average weighted by share of U.S. non-oil imports	1.3	1.6	1.8	1.7	1.8	1.2	1.1	1.2	1.2	1.2	1.2	1.2

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	------ Projected 1997	1998	1999 ------
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	0.4	-0.4	-0.6	-0.4	0.4	-0.4	-0.5	-0.9	-0.4
Exports of G&S	0.8	0.4	0.5	1.0	1.1	1.0	1.2	0.1	0.5
Imports of G&S	-0.4	-0.8	-1.1	-1.4	-0.7	-1.4	-1.7	-1.0	-0.8
	Percentage change, Q4/Q4								
Exports of G&S	8.6	4.1	4.6	10.0	10.3	9.3	10.5	0.5	4.1
Services	7.1	-0.9	4.1	6.0	9.0	4.7	3.3	-0.5	3.1
Agricultural Goods	10.1	10.4	-5.5	16.6	-3.4	5.7	2.5	-1.9	1.9
Computers	21.7	25.2	23.7	32.0	55.7	33.8	50.9	21.4	29.3
Semiconductors	41.8	64.8	32.9	66.9	80.4	45.9	18.3	21.8	33.1
Other Goods 1/	7.0	2.3	3.6	6.9	5.7	7.6	11.6	-1.7	0.9
Imports of G&S	4.1	7.4	10.2	12.3	5.6	11.8	14.1	7.9	6.5
Services	-2.7	1.4	3.2	1.4	7.3	5.0	12.6	3.3	2.4
Oil	8.1	12.1	10.1	-0.2	1.5	8.3	-0.0	6.2	2.1
Computers	35.9	45.1	39.3	44.8	46.2	23.6	42.1	20.6	26.2
Semiconductors	55.3	42.0	34.2	54.5	92.7	57.9	30.4	22.1	32.3
Other Goods 2/	2.5	5.4	9.5	12.2	-1.2	10.5	12.8	7.5	5.1
	Billions of chained 1992 dollars								
Net Goods & Services	-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-145.0	-218.5	-271.1
Exports of G&S	599.9	639.4	658.2	712.4	791.2	857.0	963.4	989.5	1020.5
Imports of G&S	622.2	669.0	728.4	817.0	890.1	971.5	1108.5	1208.0	1291.6
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-5.7	-56.4	-90.8	-133.5	-129.1	-148.2	-162.2	-205.3	-262.8
Net Goods & Services (BOP)	-31.0	-39.2	-72.3	-104.4	-101.9	-111.0	-109.8	-135.9	-183.7
Exports of G&S (BOP)	581.2	617.5	643.5	699.6	794.6	848.8	933.3	936.3	961.0
Imports of G&S (BOP)	612.2	656.7	715.8	804.1	896.5	959.9	1043.1	1072.2	1144.7
Net Investment Income	20.3	18.0	19.7	9.7	6.8	2.8	-13.0	-27.7	-37.4
Direct, Net	55.6	51.6	55.7	50.8	60.0	66.8	69.7	64.9	69.8
Portfolio, Net	-35.4	-33.6	-36.0	-41.0	-53.2	-63.9	-82.7	-92.5	-107.2
Net Transfers	5.1	-35.2	-38.1	-38.8	-34.0	-40.0	-39.3	-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 Q1	1994 Q2	1994 Q3	1994 Q4	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.3	-0.4	0.3	-0.4	0.1	1.2	1.0	-1.3	-0.6	-1.4	1.8
Exports of G&S	-0.2	1.7	1.1	1.5	0.8	1.0	1.4	1.3	0.2	1.1	0.2	2.6
Imports of G&S	-0.8	-2.0	-1.5	-1.2	-1.2	-0.9	-0.3	-0.3	-1.5	-1.7	-1.6	-0.8
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	13.8
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	-145.4	-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	-111.7	-113.2	-123.2	-95.5	-75.5	-98.1	-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.

Strictly Confidential (FR)
Class II FOMC

January 28, 1998

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

				----- Projected -----								
	1997				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	-1.0	-0.4	-1.3	0.6	-1.4	-1.2	-1.2	0.1	-0.7	-0.3	-0.8	0.2
Exports of G&S	1.1	2.0	0.5	1.1	-0.4	0.0	-0.3	0.8	0.1	0.7	0.1	0.9
Imports of G&S	-2.1	-2.5	-1.8	-0.5	-1.0	-1.2	-1.0	-0.8	-0.8	-1.0	-0.9	-0.7
	Percentage change from previous period, SAAR											
Exports of G&S	9.9	18.4	4.4	9.5	-3.1	0.0	-2.2	7.5	0.9	6.3	0.9	8.5
Services	3.7	3.2	7.2	-0.8	-4.1	0.1	0.4	1.9	2.7	3.3	3.1	3.3
Agricultural Goods	-27.6	-4.2	20.6	31.7	-12.9	-2.3	8.0	0.7	-5.4	-1.0	10.3	4.4
Computers	72.3	84.3	61.5	1.0	4.1	26.2	28.6	28.6	28.6	28.6	29.9	29.9
Semiconductors	39.0	15.7	38.8	-12.2	-3.0	28.6	32.3	33.1	33.1	33.1	33.1	33.1
Other Goods 1/	12.4	25.0	-4.6	15.6	-2.0	-3.4	-8.8	8.0	-3.6	5.1	-5.5	8.3
Imports of G&S	17.9	20.5	14.6	4.1	8.1	10.0	7.7	6.0	6.3	7.9	6.7	5.3
Services	24.2	8.9	10.1	7.9	6.9	2.7	1.9	1.8	2.3	2.3	2.4	2.6
Oil	-10.8	44.5	6.3	-27.2	-2.6	41.5	9.5	-15.7	-9.3	31.2	7.4	-14.8
Computers	51.3	71.1	53.0	3.0	7.2	23.9	26.2	26.2	26.2	26.2	26.2	26.2
Semiconductors	71.2	19.3	44.3	-2.0	-0.8	28.6	31.8	32.3	32.3	32.3	32.3	32.3
Other Goods 2/	15.3	17.1	11.8	7.3	9.9	7.8	6.4	6.1	5.7	5.1	4.9	4.8
	Billions of chained 1992 dollars											
Net Goods & Services	-126.3	-136.6	-164.1	-153.2	-183.4	-211.6	-239.4	-239.4	-256.3	-265.1	-283.7	-279.5
Exports of G&S	922.7	962.5	973.0	995.4	987.7	987.7	982.3	1000.3	1002.5	1017.9	1020.3	1041.4
Imports of G&S	1048.9	1099.1	1137.1	1148.7	1171.2	1199.4	1221.7	1239.7	1258.8	1283.0	1303.9	1320.8
	Billions of dollars											
US CURRENT ACCOUNT BALANCE	-159.9	-151.4	-170.2	-167.1	-168.9	-191.4	-222.5	-238.5	-243.1	-253.7	-272.7	-281.6
Net Goods & Services (BOP)	-117.2	-102.6	-120.1	-99.3	-107.1	-127.4	-154.4	-154.5	-170.1	-178.6	-196.0	-189.9
Exports of G&S (BOP)	897.0	939.0	939.4	957.7	940.4	935.0	926.7	943.1	944.8	958.9	960.5	979.9
Imports of G&S (BOP)	1014.2	1041.5	1059.5	1057.0	1047.5	1062.5	1081.1	1097.6	1114.9	1137.5	1156.5	1169.7
Net Investment Income	-8.0	-13.0	-13.3	-17.9	-22.7	-25.0	-29.1	-34.0	-34.0	-36.1	-37.6	-41.7
Direct, Net	69.3	70.9	69.5	69.0	66.2	65.7	64.3	63.3	67.1	69.2	71.4	71.6
Portfolio, Net	-77.3	-83.9	-82.8	-86.9	-88.9	-90.7	-93.4	-97.3	-101.1	-105.2	-109.0	-113.3
Net Transfers	-34.7	-35.8	-36.8	-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.