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Strictly Confidential (FR) Class II FOMC

Part 1

March 24, 1999

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

March 24, 1999

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee
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Domestic Developments

The economy has continued to exhibit remarkable dynamism, generating hefty gains in employment and income. We have tacked about 3/4 percentage point onto our previous forecast of first-quarter real GDP growth, and the evident momentum of domestic demand has led us to elevate our projection for output growth over the near term a bit as well.

Until the last week, it looked like we would have to carry those upward revisions further into the projection period, as the stock market was threatening once again to shoot well above the path anticipated in our previous forecast. But while that threat certainly cannot be said to have evaporated, the fall-off in share prices since the Dow Industrials touched the 10,000 level has given us at least a temporary reprieve. A number of factors reportedly have played a role in the market's hesitation, but one of them is the sense that valuations are stretched and that earnings expectations have been excessively optimistic. This, of course, has been the basic premise of our stock market view.

Absent a substantial further advance in share prices, we do not see the driver that can sustain the kind of growth of domestic demand that we have observed over the past few years. Thus, while we have raised our forecast of real GDP growth this year to 3 percent in reflection of the stronger first-half picture, we continue to foresee a substantial slackening in the pace of expansion in 2000--to about 2-1/4 percent.

These growth rates, coming on top of the upside surprise of the fourth quarter, imply that the level of economic activity is higher throughout 1999 and 2000 than in the last Greenbook. All else equal, this might have led us to elevate our inflation forecast a little. But, all else has not been equal. For one thing, the recent strong performance of productivity has prompted a slight change in our projection of output per hour that has about offset the effect of the higher GDP path on the unemployment rate. In addition, recent news on wages and consumer prices has been even more favorable than we had anticipated, and the appreciation of the dollar on foreign exchange markets should put a damper on non-oil import prices. Moreover, an apparent widening of profit margins over the past couple of quarters suggests that firms have a bit more of a cushion to absorb any cost increases in the coming months. Under the circumstances, the outlook for inflation in the near term actually looks a tad more favorable than it did earlier.

That said, by the latter part of the this year and in 2000, the rebound in oil prices and pressures on labor supplies are likely to induce an appreciable pickup in inflation. With the jobless rate edging lower in the next several months and remaining at or below the current level until late in the projection period, we expect to see core CPI inflation moving up just over 2 percent in the latest twelve months to 2-1/2 percent in 2000. Owing to the rebound in oil prices, the overall CPI accelerates from about 1-1/2 percent to 2-1/2 percent. Moreover, the trend toward higher inflation would be expected to persist into 2001.

Key Background Factors
Although that prospective deterioration of the inflation trend would suggest that maintenance of the present nominal federal funds rate will ultimately be destabilizing, we have retained for the time being the assumption that it will remain close to 4-3/4 percent at least well into next year. This is not greatly at odds with what appears to be the prevailing expectation in the fixed-income markets: Forward rates show no evidence of any anticipation of a Fed move this year and indicate that market participants are looking for only a slight firming in 2000. Our forecast has long-term rates edging up a little over the coming year, with spreads of yields on corporate bonds over those on Treasuries not narrowing much more in an environment of weaker economic growth and rising credit risk.

The backup of interest rates in recent months obviously has some negative implications for spending, but we see more considerable financial restraint on aggregate demand growth being exerted over the forecast period by a leveling out in share prices. Obviously, the market will continue to fluctuate, but it is our baseline projection that it will fluctuate generally around the average level of the current quarter--roughly 11,500 on the Wilshire 5000--rather than extending the steep bull uptrend or falling to a sharply lower level and staying there. Those are, however, definite risks in the outlook, risks that we address through model-based simulations later. The upside risk can be seen as arising simply out of the internal momentum of a market that has repeatedly shown it can slough off bad news--and in which investors, imbued with the notion that high returns are guaranteed to those who stay in for the long haul, see any dip as a buying opportunity. That sentiment may be especially difficult to overcome as long as monetary policy is expected to remain "friendly" to the market, as commentators often put it. The downside risk is that, if our projection of declining profits proves correct, investors will at some point ask where the "beef" is in the stocks for which they have been paying extraordinary price-earnings multiples.

Our forecast may constitute a somewhat awkward middle ground, but we believe it represents a reasonable balancing of the risks in the stock market outlook. If the projection proves roughly correct, the household wealth-income ratio will decline significantly over coming quarters, while the market price-earnings multiple, measured on trailing earnings, will rise further.

The dollar has appreciated during the intermeeting period against the euro and especially the yen. We are anticipating that the real value of the dollar against a broad index of currencies will rise slightly on balance over the projection period. This reflects a variety of factors, including the relative strength of the U.S. economy in the near term, even lower inflation in other industrial countries than in the U.S., an expectation that the current monetary stance in Japan will be maintained, and that a modest easing will occur in the euro area. One factor arguing at least against any further rise of the dollar is the growing current account deficit. In all, the dollar averages roughly 2 percent higher in real terms in this projection than in the January forecast.

Foreign GDP growth prospects now look a bit less gloomy. Overall foreign economic growth, which was about 1/2 percent last year, is expected to rise to 2-1/2 percent in 2000. We still expect that Brazil's financial troubles will lead to a significant recession in that country, but the financial spillovers to other countries thus far have been considerably less severe than we had anticipated earlier. Most important for the United States, Mexico has been relatively unaffected; indeed, in contrast to our January projection of declining GDP this year, we now expect that Mexico will achieve modest growth both this year and next. In Canada, GDP growth in the final quarter of last year came in above our expectations--no doubt owing in part to the strong U.S. economy--and we have revised up our growth projection for this year as well. For areas outside of the Americas, we have made only small changes to our growth forecasts, as--for better or worse--developments seem to have been tracking pretty closely to our expectations.

The same might be said for oil prices, which, as predicted, have turned up sharply, with the spot price of WTI crude now back above $15 per barrel. Key to the outlook from here is the degree to which the oil-exporting countries can implement the production cuts they agreed upon in recent days. We are assuming that, although there will be some cheating on the agreement, WTI spot prices will trend upward, reaching $17 per barrel by the end of 2000--about $.50 to $1 above the path in the last Greenbook.

We have not changed our basic fiscal policy assumptions, and policy is assumed to remain essentially neutral in terms of impetus to demand. However, given the stronger economy and some technical adjustments to our revenue forecast, our projection now calls for unified budget surpluses of about $122 billion in FY1999 and $169 billion in FY2000--both roughly $25 billion higher than in our last projection.

Recent Developments and Outlook for the Current Quarter

With almost uniformly strong incoming data on domestic spending, we now project that real GDP will rise at an annual rate of about 3-1/2 percent in the current quarter. This is well below the 6 percent pace of the fourth quarter, which was boosted substantially by a post-strike rebound in motor vehicle production. Production worker hours have risen appreciably thus far in 1999 on the strength of increases in private payrolls averaging more than 200,000 per month, and low initial claims for unemployment insurance benefits suggest that hiring has remained brisk in March.

Private domestic final purchases have been tremendously strong again this quarter, paced by household demands. We now think that consumption expenditures will rise at a 6 percent annual rate--well above last year's pace. Retail sales soared in January and February, and service outlays were up sharply in January. One of the biggest surprises--to us and also to the automakers--has been the sustained high level of light vehicle sales, which seem to be on track to match the 16-1/4 million unit volume (annual rate) of the fourth quarter. The housing market has shown some hints of a peaking of demand in recent months, probably in part because of the rise in mortgage rates since last fall. However, building activity will be up markedly further this quarter: Total housing starts jumped to an average of 1.8 million units at an annual rate in January and February, and we estimate that real residential investment expenditures will increase at an 11-1/2 percent rate this quarter.

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

Measure	1998:Q4		1999:Q1	
	Jan. GB	Mar. GB	Jan. GB	Mar. GB
Real GDP	5.0	5.9	2.7	3.4
Private domestic final purchases	6.3	6.3	3.2	6.7
Personal consumption	4.7	4.6	2.7	6.0
Residential investment	12.5	10.6	7.9	11.6
Business fixed investment	14.0	15.8	4.5	9.1
Government outlays for consumption and investment	3.1	3.3	.8	1.4
	Change, billions of chained (1992) dollars			
Inventory investment	-17.4	-7.9	20.3	-7.7
Net exports	-2.0	7.7	-26.5	-45.7

Business fixed investment appears to have decelerated from the 15-3/4 percent advance of the fourth quarter, but another substantial increase still seems likely. We have put it at about 9 percent at an annual rate. Shipments of nondefense capital goods excluding aircraft fell in the first two months of the year, but we think a larger share of those shipments have gone to domestic purchasers. Shipments of medium and heavy trucks have skyrocketed. Holding down the increase in equipment spending this quarter is a slower growth in purchases of light vehicles and commercial jets, which surged at the end of last year; the increases in those categories should, however, still be very large. Investment in nonresidential structures seems likely to change little this quarter, with the construction put-in-place figures for January pointing to a continued strength in office building but weakness elsewhere.

Monthly Treasury statements through February indicate that federal purchases will fall off some this quarter. In contrast, in the state and local sector, total purchases probably will be up smartly this quarter, even discounting the almost unbelievable surge in road building reported for January.

We expect net exports to more than reverse their surprising fourth-quarter bulge. Although we have only a few hard data to go on, the widening of the trade deficit in January obviously supports this expectation. By our reckoning, exports alone might slice nearly 1 percentage point from final sales this quarter, after having contributed 2 percentage points in the fourth quarter. This drag is tempered a bit by a projected slowdown in import growth, which also was unusually high late last year.

We suspect that the boom in final sales may have surprised businesses in a number of sectors. As a result, inventory accumulation may be on the slim side in the current quarter. The January book-value data, our only semi-firm evidence at the moment, show that stocks at manufacturing and non-auto trade establishments were essentially flat. Certainly, the surprising volume of motor vehicle sales ought to result in only a small inventory build in that area.

Inflation has remained low. Both the overall CPI and the index excluding food and energy items increased but 0.1 percent in January and again in February. The twelve-month change in the core CPI has receded to just 2.1 percent despite the whopping tobacco price increases that added about 0.4 percentage point to the index over the past year. On the wage side, average hourly earnings increases have been more moderate in recent months.

The Outlook for Economic Activity Beyond the Current Quarter
Given the continued stunning performance of the economy, there is a strong temptation merely to predict more of the same--4 percent real GDP growth and sustained low inflation. However, while we have made some notable adjustments in our forecast in light of recent developments, we believe it sensible to stick with the basic elements of our previous, less upbeat story. As noted earlier, the recent hesitation of the stock market may be some tentative confirmation of our thinking that valuation will provide some restraint on equity prices. And without a continuation of huge increases in share prices, demand should rise more moderately--especially given that the stocks of consumer durables, houses, and business equipment already increasing rapidly at current levels of expenditure. On the supply side, despite grounds for some greater optimism about productivity trends, it appears unlikely that the labor market can accommodate continued 4 percent GDP growth without the emergence of more bottlenecks and increasing cost pressures.

Consumer spending. Even after taking into account the rapid growth of income and wealth, consumer demand has continued to outstrip our expectations. Perhaps the mortgage refinancing wave, which appears to have liquified a considerable amount of home equity, has spurred spending more than was implicit in our forecasts. And, recognizing the uncertainties attending estimates of wealth effects, one cannot rule out the possibility that those effects have come more quickly or more powerfully than we have been allowing for in our forecasts. In any event, we have in effect carried forward the higher-than-expected levels of demand; this is reflected, for example, in the considerable further lowering of the personal saving rate in this projection.[1]

Real PCE is projected to rise 4-1/2 percent this year. Several factors should help sustain consumer demand in the near term. One is the enlarged volume of income-tax refunds. In particular, many households may not have fully anticipated the effects of the new child and education tax credits on their 1998 liabilities, and therefore a part of whatever influence those credits may

1. As a matter of accounting, the lower projected saving rate also reflects a higher path of personal tax payments. Although it is too soon to judge with any confidence, it looks like households may have received more non-labor income, such as capital gains realizations and pension or IRA distributions, in 1998 than we (or CBO) had anticipated. These types of "income" are not included in the NIPA definition of personal income. An increase in the related tax payments, therefore, leads to a lower NIPA measure of personal saving, other things equal. Households presumably recognized these liabilities earlier (even if we didn't), and adjusted their spending accordingly; so, this change in the forecast of disposable income did not influence our projected spending path.

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

Measure	1997	1998	1999	2000
Real GDP	3.8	4.2	3.0	2.2
Previous	3.8	4.0	2.6	2.4
Final sales	3.4	4.5	2.9	2.3
Previous	3.4	4.4	2.5	2.4
PCE	3.7	5.2	4.6	2.7
Previous	3.7	5.2	3.5	2.8
Residential investment	4.2	12.7	.3	-3.0
Previous	4.2	13.2	.2	-2.2
BFI	9.8	12.2	6.1	6.5
Previous	9.8	11.8	5.8	5.8
Government purchases	1.4	1.6	1.6	2.0
Previous	1.4	1.6	1.4	1.8
Exports	9.6	.9	-.5	4.0
Previous	9.6	.7	.2	4.4
Imports	14.0	9.7	8.4	6.9
Previous	14.0	10.4	6.1	6.7
	Change, billions of chained (1992) dollars			
Inventory change	34.4	-18.7	5.6	-13.8
Previous	34.4	-28.3	4.0	-.7
Net exports	-53.1	-102.4	-111.0	-54.5
Previous	-53.1	-112.0	-75.2	-46.1

exert on spending could still lie ahead. Second, demand for household appliances and furnishings may be supported by the recent high levels of home sales and starts. Third, although we think that the recent pace of motor vehicle sales is simply too high to be sustained for very long, continuing relative price declines could buoy vehicle sales for a few months more if the automakers are content to give up some of their profits in the battle for market share.

Another special factor this year, and one whose importance is extremely difficult to assess, is fears of Y2K disasters. Polls show that many people are expecting disruptions and intend to take some precautions. Even so, we remain hesitant to build into our forecast more than a minor fillip to PCE from this phenomenon. Rather, for the time being, we are flagging this as a modest upside risk to the 1999 spending projection; we shall attempt to monitor developments in the months ahead.

Of course, a bigger Y2K impetus this year would mean a bigger drag on the other side of January 1, 2000. But the major element in our story of further moderation in PCE growth next year is a downturn in the wealth-income ratio and a slackening in growth of labor income associated with the general deceleration of activity. Our projection calls for PCE growth of 2-3/4 percent in 2000. The saving rate does not turn up next year because of lags in the wealth effect and the tendency for changes in the growth of income to affect the spending patterns of households only gradually.

Residential investment. The surge in seasonally adjusted housing starts over the past several months probably exaggerates the underlying trend of construction. Faced with a growing backlog of demand and enjoying rising house prices, builders likely were willing to incur the extra cost of keeping construction projects going in the less favorable conditions of the late fall and winter months. And unusually mild weather made that effort easier. In light of the tight supplies of workers and of some materials, builders might find it difficult to achieve the normal seasonal pickup in starts over the next few months; in any event, some caution may begin to creep into their plans, given the rise in mortgage rates and a softening of demand indicators since last fall.

On a seasonally adjusted basis, we expect starts to drop off appreciably this spring and to run closer to the 1.6 million mark by this summer. A further moderate decline is projected for 2000 as income continues to decelerate and the impetus from the stock market wanes. The level of residential building will remain quite substantial, though. Mortgage interest rates have remained rather high relative to Treasury yields, and we expect a significant narrowing over the next year. Consequently, despite rising real house prices, we see home affordability remaining supportive of demand in the single-family sector.

Business fixed investment. In contrast to household spending, business investment has shown some signs of deceleration, albeit from extremely rapid growth rates. We expect growth in real BFI, which was 12 percent in 1998, to run at about half that rate in both 1999 and 2000. The reasons for the slowing are the same as in previous forecasts: Growth of the capital stock is already quite rapid at the present level of investment; in significant parts of the manufacturing sector, capacity utilization has dropped to distinctly subpar levels and profitability has suffered materially. A continuing decline in equipment prices is thus unlikely to outweigh negative "accelerator" effects over coming quarters.

The anticipated moderation in capital spending is most marked with respect to equipment. We expect to see absolute declines in the levels of expenditure for aircraft and motor vehicles later this year and next; we may also see further declines this year for some categories of agricultural and industrial machinery. Real outlays for communications equipment likely will continue to grow quite rapidly owing to the ongoing changes in the organization and technology of that sector. The outlook for computing equipment--which we have long found difficult to assess--is subject to the extra uncertainty associated with Y2K preparation. The recent shipments figures hint that business purchases of computers are rising less dramatically than they did during most of 1998. This could be a sign that firms accelerated their equipment-replacement cycles last year, drawing off some potential purchases from later periods. On average this year and next, we see real spending on office and computing equipment rising at roughly half the 65 percent pace of 1998.

Spending on nonresidential structures has been one of the few areas of weakness in final demand, and we see little action from this sector going forward. There are many cross-currents. Among the major components, both the industrial and retail segments of the market are characterized by elements of excess capacity, and the new contracts for construction have been falling. On the other hand, the market for office space looks quite healthy on the whole, and we also would expect to see increases in building by public utilities.

Government. As in past Greenbooks, real federal purchases are expected to continue falling slowly over the next two years, with slightly larger declines in the defense area than in nondefense expenditures. As before, we expect that spending caps will be exceeded by roughly $15 billion of "emergency" spending in the current fiscal year, and about $10 billion next year.

By contrast, our projection of state and local expenditures has been revised upward for this year and next. The financial positions of states and localities are excellent in the aggregate, with current-account surpluses having reached $100 billion last year. In this environment, a pickup in spending seems likely, and we are expecting real purchases to rise 3-1/2 percent per year. Many analysts have pointed to last year's federal highway bill as having provided a considerable impetus to construction. Although we believe that this story has often been overstated, we are taking the January surge in construction activity to be a signal--albeit an exaggerated one--that infrastructure spending is on a somewhat steeper upswing now than had been reflected in our previous forecasts.

Business inventories. In the fourth quarter of last year, nonfarm inventories (other than motor vehicles) were accumulated at about a 2-3/4 percent annual rate. As noted earlier, we suspect that the rate of inventory building has remained quite moderate in the current quarter, largely as a consequence of upside sales surprises. In the aggregate, inventories have dropped sharply relative to final sales, and stocks probably have become even leaner than many businesses would desire. As a result, our forecast assumes that firms will seek to raise the pace of inventory investment, providing a boost to GDP growth in the second quarter. Inventories are about a neutral influence on economic growth for the remainder of this year: What would otherwise have been a small downshift in inventory investment at the end of this year is offset by a moderate build-up attributable to Y2K precautions. We therefore expect a small decline in stockbuilding next year as these excess inventories are worked off.

Auto dealers might like to have more of the popular SUVs and pickups on their lots, but manufacturers are bumping against capacity limits in the production of light trucks. Moreover, this winter the automakers largely replenished dealers' supplies of cars, and we have assumed only a little more restocking in the coming months. We do not anticipate any major swings in motor vehicle inventory investment over coming quarters. The most obvious risk to this placid picture is the expiration of the UAW contracts this summer. Model-year build-out plans are said to be pretty well locked in with suppliers at this point, and the announced schedules--showing a small decline in assemblies in the next few months--give no hints of precautionary stocking.

We are projecting that farm inventories will continue rising, but at a slower pace than they have over the past two or three years. For that slowing to occur, however, farmers likely will need to adjust production to some degree, given that the prospects for agricultural exports are poor. Although, on the surface, the anticipated persistence of low farm prices would seem to be a strong motivation for farmers to produce less, some potentially offsetting influences pose risks to our forecast: Costs that can be varied on an annual basis are even lower than prices for most producers; some of the government support programs that remain on the books might hold total returns to producers above what the low market prices alone would imply; if acreage cutbacks are small in total, they could be swamped by further gains in productivity; and farmers and their creditors may be betting on more federal aid than is contemplated in the current "Freedom to Farm" program.

Net exports. The external sector appears likely to make a larger negative contribution to projected GDP growth in 1999 and 2000 than indicated in the January Greenbook. The greater appreciation of the dollar, with a lag, slows export growth and shifts domestic expenditures toward imports. In addition, the more rapid growth of domestic income spurs higher import spending. All told, we now think that the arithmetic drag on 1999 GDP growth from net exports will be about the same as the 1.1 percentage point registered in 1998. We still expect this drag to diminish considerably next year, when exports should strengthen with the world economy and domestic demand is projected to moderate. (A more detailed discussion of the outlook for net exports is contained in the International Developments section.)

Labor markets. The continued strength of final demand has been met both by rising payrolls and by marked increases in labor productivity. Payroll growth averaged nearly 250,000 per month in January and February, about the same as the 1998 pace. Given that many firms have been operating short-staffed for a while and looking to fill vacancies, we expect payroll gains to remain sizable even as output growth begins to taper off. With payrolls continuing to rise close to 200,000 per month into the summer, the unemployment rate should edge down a bit further. We project that job gains will slow gradually to around 110,000 per month next year, whereupon the unemployment rate should inch back up to about 4-1/2 percent.

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

Measure	1997	1998	1999	2000
Output per hour, nonfarm business	1.5	2.7	1.8	1.7
Previous	1.7	2.4	1.4	1.8
Nonfarm payroll employment	2.7	2.3	2.0	1.0
Previous	2.7	2.3	1.7	1.2
Employment, household survey	2.1	1.3	1.7	.6
Previous	2.1	1.3	1.3	.9
Labor force participation rate[1]	67.1	67.1	67.2	67.2
Previous	67.1	67.1	67.2	67.2
Civilian unemployment rate[1]	4.7	4.4	4.2	4.5
Previous	4.7	4.4	4.3	4.4

1. Percent, average for the fourth quarter.

Given the surge in fourth-quarter GDP growth, which was mirrored in a step-up in labor productivity, output per hour in the nonfarm business sector now appears to have risen 2-3/4 percent over 1998. Obviously, an important question is to what extent that relatively high figure represents transitory factors rather than structural improvements that can be extended over the projection period. The answer to this question is not clear cut, but we have taken a small step in the structural direction by edging up our estimate of "trend" productivity growth since mid-1995 to 1.9 percent.[2] This change makes the Okun's Law relationship between output and unemployment fit slightly better and also helps rationalize the continued low inflation and strong real compensation gains we have seen. Furthermore, last year's productivity gain was achieved in the face of what generally is thought to be a modest drag from Y2K preparation;. In thinking about whether these structural increases can be continued, we are impressed by the levels of investment, often reported to be aimed at enhancing efficiency, and also by the apparent continuation of firms' efforts to trim unneeded staff. We have anticipated that productivity gains over 1999 and 2000 will average 1-3/4 percent per year--a bit below the assumed trend, because of the appreciable deceleration of output.

Wages and prices. The incoming data on inflation have been consistently favorable, and we expect this good news to continue for a while longer. In many industries, firms report that, given competitive forces, they still have very little scope to raise prices; the effects of the recent appreciation of the dollar ought to reinforce that view, especially in goods markets, in the coming months. Thus, we have reduced our projected rise in the CPI excluding food and energy to 2.1 percent this year--a touch below the 2.4 percent rise in 1998, once methodological changes to the CPI are taken into account. We project that the overall CPI will rise 2.2 percent this year, up from last year's 1.5 percent increase, which reflected the sharp drop in energy prices.

A further substantial pickup of inflation appears in store for 2000, and we project that both total and core CPI inflation will move up to around 2-1/2 percent. The reasons for the pickup are basically the same as in previous Greenbooks and represent the balancing of a variety of factors. The decline in the price of non-oil imports already has slowed, and even with the new exchange-rate path, a slight upturn is likely by next year--the product of a flattening dollar and a firming of commodity markets as growth resumes in the economies of Asia and Latin America. The indirect effects of the turnaround in energy prices also tend to add to core inflation over time. On

2. Accordingly, we have raised our estimate of potential output growth by 0.1 percentage point, to 2.9 percent.

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

Measure	1997	1998	1999	2000
Consumer price index	1.9	1.5	2.2	2.4
Previous	1.9	1.5	2.3	2.4
Food	1.7	2.2	1.9	2.0
Previous	1.7	2.3	1.7	2.1
Energy	-1.2	-9.2	5.2	1.5
Previous	-1.0	-9.0	3.0	1.4
Excluding food and energy	2.2	2.4	2.1	2.5
Previous	2.2	2.4	2.3	2.6
PCE chain-weighted price index	1.5	.7	1.6	1.8
Previous	1.5	.8	1.7	1.9
Excluding food and energy	1.6	1.2	1.4	1.8
Previous	1.6	1.2	1.6	1.8
GDP chain-weighted price index	1.7	.9	1.5	1.9
Previous	1.7	.9	1.5	1.9
ECI for compensation of private industry workers[1]	3.4	3.5	3.4	3.5
Previous	3.4	3.5	3.5	3.7
Prices of core non-oil merchandise imports	-.7	-2.0	.5	1.0
Previous	-.7	-2.0	1.5	1.4
	Percentage points			
MEMO: *Adjustments for technical changes to the CPI*[2]				
Core CPI	.2	.4	.6	.6

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

the more optimistic side, our projection for inflation is tempered by the consideration that, given prospects for continued ample manufacturing capacity here and abroad, pricing leverage is likely to remain quite limited in many goods markets.

Also contributing to our optimism with respect to the inflation outlook is our view that nominal compensation gains probably will be pretty level, despite the tightness of the labor market. Recent more moderate readings on wage inflation do not definitively prove that we were correct in predicting that pay gains would mirror with a lag the lower rate of price increase in the past couple of years--but they certainly do not contradict that view. In forecasting essentially stable 3-1/2 percent ECI compensation inflation, we arguably have been conservative in terms of what the lagged inflation story might imply. We have taken account of the possibility that relevant price expectations have not come down as much as some actual inflation measures and of the likelihood that costs of health insurance and other benefits will be accelerating.

Measured in product-price terms, real compensation gains are projected to be sizable in 1999 and 2000--though less so than last year, when inflation surprised everyone on the downside. With productivity growth slowing, unit labor costs will re-accelerate; other elements of the cost structure will be moving unfavorably as well, including interest expenses. The further compression of unit profits is reflected in our projection that the profit share of GNP will decline appreciably further.

Monetary and Credit Flows
Growth of the aggregate debt of domestic nonfinancial sectors has slowed in the current quarter, to somewhere around 5-1/2 percent at an annual rate versus 6-1/4 percent on average in 1998. But, while slowing has been evident in all the major sectors, the pace of borrowing has remained quite high for businesses and households.

In the business sector, there has been a considerable unwinding of the tensions that afflicted the credit markets last fall, and firms have been able to return to the securities markets both for new funds and to repay bank loans. Among households, credit supply conditions never became a major issue, but the improvement in asset-backed securities markets undoubtedly has benefitted borrowers. And borrowers have been in abundance: Consumer credit surged in January, likely reflecting importantly the burst of spending on autos and other big-ticket durables, while mortgage borrowing likely has remained sizable due to heavy home purchases and cash-out refinancings. Meanwhile, state and local government borrowing has been moderate, and the federal government has run off a significant amount of debt on a seasonally adjusted basis.

We expect that borrowing will slow a bit further over the course of this year, especially in the private sectors. Overall debt growth is projected to run about 5 percent for the year. An expected further deceleration in 2000 reflects the growing federal budget surplus and diminishing credit demands from households and businesses.

Profits of nonfinancial corporations are expected to weaken further over the balance of 1999, widening the financing gap substantially. The pace of business borrowing nonetheless is expected to slow, as merger-related credit demand abates and the pace of stock buybacks moderates. For the year, the growth of business sector debt is expected to be down about 2 percentage points from the 9-1/4 percent rise in 1998. A further 1 percentage point slowing is projected for 2000 as equity retirements fall further. With corporate debt levels up, some signs of deterioration in business credit quality already have emerged in the form of moderate rises in charge-off and delinquency rates on business loans at commercial banks and some pickup in junk bond default rates. This trend is likely to continue as the pace of economic expansion slows and interest coverage ratios decline. However, with bond yield spreads already fairly wide, especially in the junk sector, we anticipate little if any further widening over the projection period. Banks may tighten standards and terms somewhat, but again, we do not foresee a major shift in conditions.

Household debt is expected to grow 8-1/4 percent over 1999 and 7-1/4 percent in 2000, outpacing the expansion in other sectors. The reduction in borrowing this year is projected to occur entirely in the mortgage market, reflecting the drop-off in housing activity and less equity extraction through refinancings. However, in 2000, a slowing in consumer debt growth should contribute as well to the moderation in household borrowing, as spending--especially on consumer durables--decelerates considerably. Household debt has increased substantially relative to income in recent years, and we expect the steep uptrend to continue. To date, the burden of servicing those debts has been moderated by declining interest rates and the ability of households to lengthen maturities by substituting mortgages for consumer loans. As with the business sector, the slackening in the pace of economic expansion probably will bring with it some deterioration in credit quality in mortgage and consumer loan portfolios--but, again, we are not talking about anything remotely resembling recessionary economic conditions, and the deterioration in debt repayment performance is unlikely to be so great as to precipitate a major shift in lender behavior.

The upward movement of interest rates on taxable bonds since January has been only partly reflected in municipal bond rates; the ratio of tax-exempt to taxable yields has come down from its extraordinarily high level of last fall, but it still remains relatively high by historical standards. While this might suggest some hesitancy on the part of traditional muni investors--or of "crossover" buyers--there is no indication that financing conditions are difficult, and the sound budgetary condition of most states and localities should keep credit quality concerns to a minimum. Consequently, funding should remain readily available for the increased volume of investment projects anticipated in our GDP forecast. Advance refunding operations should be smaller in volume than in the past few years because rates have been low enough for long enough that a relatively small stock of bonds remains eligible.

The appreciable surplus in the federal budget means that the government will be retiring significant amounts of debt over the projection period. In 1998, federal debt fell about 1-1/2 percent, and the run-off pace will average 4 percent over 1999 and 2000. The retirement of securities has given rise to some challenges for debt management as the Treasury seeks to maintain the liquidity of its benchmark issues. The indications are that there will be a combination of reduced frequencies and sizes of issues cutting across both nominal and indexed marketable securities.

The unwinding of financial strains since last fall has damped growth of the monetary aggregates. As investors have returned to bond and equity markets, both directly and through mutual funds, demand for the liquid components of M2 has weakened appreciably. Demand for these monetary instruments also has been weakened by the waning effect of last fall's Fed easings. For this year, M2 growth is projected to decelerate considerably more than nominal income. M2 velocity nevertheless declines in 1999 and in 2000, albeit by less than in recent years. For M3, growth has been held down by reduced funding needs resulting from the recent decline of bank credit. M3 growth is expected to decelerate substantially this year and to continue to grow at a more moderate rate in 2000.

Alternative Simulations

Our alternative, model-based simulations present the implications of a more substantial monetary tightening and of several different scenarios for the stock market.

As we noted, our forecast suggests that a tightening of policy ultimately may be necessary to curb an upward trend in the rate of inflation. In the first alternative, the federal funds rate rises to 6 percent by a year from now. As a result, GDP growth is a bit lower this year and is down 1 percentage point in 2000, with the unemployment rate reaching 5 percent by the end of the projection. This slowing is enough to prevent any increase in core CPI inflation next year.

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

Measure	1999	2000
Real GDP		
Baseline	3.0	2.2
Tighter monetary policy	2.8	1.1
25 percent stock price decline	2.3	1.0
Stable equity wealth/income	3.0	2.5
15,000 Wilshire	3.2	3.2
Civilian unemployment rate[1]		
Baseline	4.2	4.5
Tighter monetary policy	4.3	5.0
25 percent stock price decline	4.4	5.1
Stable equity wealth/income	4.2	4.4
15,000 Wilshire	4.2	4.2
CPI excluding food and energy		
Baseline	2.1	2.5
Tighter monetary policy	2.1	2.1
25 percent stock price decline	2.1	2.4
Stable equity wealth/income	2.1	2.5
15,000 Wilshire	2.1	2.5

1. Average for the fourth quarter.

The remaining alternatives consider different paths for the stock market. Whereas the baseline for this Greenbook assumes that share prices change little from here, the second alternative takes the much more pessimistic view that stock values plummet 25 percent in the second quarter and remain flat at that lower level thereafter--not implausible, given that the market may be quite substantially overvalued. In this scenario, GDP growth is considerably lower both this year and next, and the unemployment rate rises above 5 percent next year. However, despite the substantial growth and unemployment effects of this alternative, core CPI inflation is only a little lower next year in this scenario. This results from a particular feature of the FRB/US model. In this model, expectations of inflation are relatively slow to respond to fluctuations in resource utilization that are not accompanied by changes in monetary policy--in part because people have come to expect that monetary policy will move to prevent a change in inflation. Were we to extend the simulation beyond 2000, though, a more substantial effect on inflation would show up before long, as agents gradually inferred the Fed's intentions.[3]

The third alternative assumes that the ratio of stock market wealth to income does not decline next year but holds steady throughout the projection. This might be viewed as, in a sense, a more "neutral" assumption than is our baseline. In this case, GDP growth in 2000 is just a little higher, and the unemployment rate a bit lower, relative to the baseline.

Finally, the fourth alternative is more optimistic still: It calls for the Wilshire 5000 index to rise to 15,000--roughly 30 percent higher than today's close--by the end of 2000. This pace might seem improbable, but we might have said the same thing two years ago--and been wrong, as we were. GDP growth is considerably higher, and the unemployment rate considerably lower, than in the constant wealth-to-income ratio scenario. Again, though, it has a very small effect on the inflation rate through 2000 given the way expectations are determined in this model.

3. As with inflation, the response of the unemployment rate also is somewhat muted in the stock-market scenarios--in this case relative to what would be predicted by Okun's Law. This result is a consequence of the forward-looking nature of employment decisions in the model: Firms expect the stock market decline--and the accompanying reduction in spending--to be temporary and therefore delay their reduction in employment.

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March 24, 1999

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]	
		01/28/99	03/24/99	01/28/99	03/24/99	01/28/99	03/24/99	01/28/99	03/24/99	01/28/99	03/24/99
ANNUAL											
1996		5.4	5.4	3.4	3.4	1.9	1.9	3.0	3.0	5.4	5.4
1997		5.9	5.9	3.9	3.9	1.9	1.9	2.3	2.3	4.9	4.9
1998		4.9	4.9	3.8	3.9	1.0	1.0	1.6	1.6	4.5	4.5
1999		4.5	4.9	3.1	3.6	1.3	1.3	2.1	2.0	4.3	4.2
2000		4.1	4.1	2.3	2.3	1.8	1.7	2.4	2.4	4.4	4.4
QUARTERLY											
1997	Q1	7.2	7.2	4.2	4.2	2.8	2.8	2.0	2.0	5.2	5.2
	Q2	5.6	5.6	4.0	4.0	1.7	1.7	1.5	1.5	5.0	5.0
	Q3	5.4	5.4	4.2	4.2	1.2	1.2	1.8	1.8	4.9	4.9
	Q4	4.2	4.2	3.0	3.0	1.1	1.1	2.3	2.3	4.7	4.7
1998	Q1	6.4	6.4	5.5	5.5	0.9	0.9	0.5	0.5	4.6	4.6
	Q2	2.7	2.7	1.8	1.8	0.9	0.9	2.0	2.0	4.4	4.4
	Q3	4.7	4.7	3.7	3.7	1.0	1.0	1.7	1.7	4.5	4.5
	Q4	6.0	6.8	5.0	5.9	1.0	0.8	2.0	2.0	4.4	4.4
1999	Q1	4.4	5.1	2.7	3.4	1.7	1.6	2.1	1.6	4.3	4.3
	Q2	3.9	4.6	2.4	3.2	1.4	1.4	2.4	2.8	4.3	4.2
	Q3	3.8	3.8	2.2	2.3	1.5	1.5	2.3	2.3	4.3	4.2
	Q4	4.5	4.5	2.9	3.0	1.5	1.4	2.3	2.2	4.3	4.2
2000	Q1	3.2	2.8	1.0	0.7	2.2	2.1	2.5	2.3	4.3	4.3
	Q2	4.8	5.4	3.0	3.6	1.8	1.7	2.4	2.4	4.4	4.3
	Q3	4.3	4.0	2.4	2.2	1.8	1.8	2.4	2.4	4.4	4.4
	Q4	4.8	4.1	2.9	2.2	1.8	1.8	2.4	2.4	4.4	4.5
TWO-QUARTER[3]											
1997	Q2	6.4	6.4	4.1	4.1	2.2	2.2	1.8	1.9	-0.3	-0.3
	Q4	4.8	4.8	3.6	3.6	1.2	1.2	2.0	1.9	-0.3	-0.3
1998	Q2	4.6	4.6	3.7	3.7	0.9	0.9	1.2	1.4	-0.3	-0.3
	Q4	5.4	5.7	4.3	4.8	1.0	0.9	1.9	1.7	0.0	0.0
1999	Q2	4.1	4.9	2.5	3.3	1.6	1.5	2.3	2.2	-0.1	-0.2
	Q4	4.1	4.2	2.6	2.7	1.5	1.5	2.3	2.3	-0.0	-0.0
2000	Q2	4.0	4.1	2.0	2.1	2.0	1.9	2.4	2.3	0.1	0.1
	Q4	4.6	4.0	2.7	2.2	1.8	1.8	2.4	2.4	-0.0	0.2
FOUR-QUARTER[4]											
1996	Q4	5.8	5.8	3.9	3.9	1.8	1.8	3.2	3.1	-0.3	-0.3
1997	Q4	5.6	5.6	3.8	3.8	1.7	1.7	1.9	1.9	-0.6	-0.6
1998	Q4	5.0	5.1	4.0	4.2	0.9	0.9	1.5	1.5	-0.3	-0.3
1999	Q4	4.1	4.5	2.6	3.0	1.5	1.5	2.3	2.2	-0.1	-0.2
2000	Q4	4.3	4.1	2.4	2.2	1.9	1.9	2.4	2.4	0.1	0.3

1. For all urban consumers.
2. Level, except as noted.
3. Percent change from two quarters earlier; for unemployment rate, change in percentage points.
4. Percent change from four quarters earlier; for unemployment rate, change in percentage points.

Strictly Confidential <FR> Class II FOMC

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

March 24, 1999

Item	Units[1]	1992	1993	1994	1995	1996	1997	- - - Projected 1998	1999	2000 - - -
EXPENDITURES										
Nominal GDP	Bill. $	6244.4	6558.1	6947.0	7269.6	7661.6	8110.9	8510.3	8929.7	9292.9
Real GDP	Bill. Ch. $	6244.4	6389.6	6610.7	6761.7	6994.8	7269.8	7551.6	7824.7	8004.7
Real GDP	% change	3.6	2.4	3.3	2.1	3.9	3.8	4.2	3.0	2.2
Gross domestic purchases		4.0	3.0	3.6	1.6	4.2	4.4	5.3	4.1	2.6
Final sales		3.9	2.1	2.7	2.7	3.7	3.4	4.5	2.9	2.3
Priv. dom. final purchases		4.9	3.7	3.7	2.9	4.3	4.6	6.5	4.5	2.9
Personal cons. expenditures		4.2	2.7	3.1	2.6	3.3	3.7	5.2	4.6	2.7
Durables		9.4	7.4	6.3	4.5	5.8	7.4	12.2	6.3	3.7
Nondurables		3.4	1.6	3.0	1.7	2.8	2.0	4.8	5.4	2.3
Services		3.6	2.3	2.5	2.6	3.0	3.8	4.0	3.8	2.8
Business fixed investment		5.5	9.9	7.6	7.3	11.7	9.8	12.2	6.1	6.5
Producers' dur. equipment		9.6	12.2	10.2	9.1	11.8	12.7	17.1	8.3	8.6
Nonres. structures		-3.4	4.5	1.1	2.7	11.6	2.5	0.0	0.0	0.6
Residential structures		16.9	7.8	4.2	-1.4	5.4	4.2	12.7	0.3	-3.0
Exports		4.1	4.6	10.0	10.5	10.3	9.6	0.9	-0.5	4.0
Imports		7.4	10.2	12.3	5.6	11.8	14.0	9.7	8.4	6.9
Gov't. cons. & investment		1.7	-1.4	0.1	-0.9	2.1	1.4	1.6	1.6	2.0
Federal		1.3	-6.1	-3.9	-5.6	1.1	-0.6	0.9	-2.0	-0.6
Defense		-1.3	-6.9	-6.0	-5.0	-0.1	-1.4	-1.4	-2.6	-0.6
State & local		2.0	2.0	2.7	2.1	2.8	2.6	2.1	3.6	3.4
Change in bus. inventories	Bill. Ch. $	7.0	22.1	60.6	27.7	30.0	63.2	58.3	50.0	42.0
Nonfarm		2.0	29.5	49.0	37.7	23.2	58.8	50.9	46.1	40.5
Net exports		-29.5	-70.2	-104.6	-96.5	-111.2	-136.1	-238.5	-334.8	-402.5
Nominal GDP	% change	6.3	5.0	5.8	4.2	5.8	5.6	5.1	4.5	4.1
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	108.6	110.7	114.1	117.2	119.6	122.7	125.8	128.5	130.3
Unemployment rate	%	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4.2	4.4
Industrial prod. index	% change	3.6	3.3	6.5	3.5	5.3	6.6	1.9	3.6	1.9
Capacity util. rate - mfg.	%	79.5	80.5	82.5	82.7	81.4	82.0	80.8	79.8	79.9
Housing starts	Millions	1.20	1.29	1.46	1.35	1.48	1.47	1.62	1.66	1.57
Light motor vehicle sales		12.85	13.86	15.01	14.72	15.05	15.02	15.50	15.68	15.04
North Amer. produced		10.51	11.71	12.88	12.82	13.35	13.09	13.47	13.51	13.08
Other		2.34	2.15	2.13	1.90	1.70	1.92	2.04	2.16	1.96
INCOME AND SAVING										
Nominal GNP	Bill. $	6255.5	6576.8	6955.2	7287.1	7674.0	8102.9	8489.8	8888.3	9234.3
Nominal GNP	% change	6.2	5.1	5.7	4.4	5.6	5.2	5.1	4.2	3.9
Nominal personal income		7.2	4.0	5.2	4.6	5.9	5.4	5.1	5.0	4.5
Real disposable income		4.0	1.2	2.5	2.1	2.7	2.9	3.5	3.3	2.6
Personal saving rate	%	5.7	4.4	3.5	3.4	2.9	2.1	0.5	-0.6	-0.8
Corp. profits, IVA & CCAdj.	% change	11.3	19.0	14.1	14.6	7.7	7.7	3.9	-2.8	0.4
Profit share of GNP	%	6.8	7.5	8.2	9.2	9.8	10.1	9.8	9.4	8.9
Excluding FR Banks		6.6	7.2	7.9	8.9	9.5	9.8	9.5	9.2	8.6
Federal surpl./deficit	Bill. $	-280.9	-250.7	-186.7	-174.4	-110.3	-21.1	75.3	148.1	186.9
State & local surpl./def.		86.3	87.4	96.8	111.7	122.6	134.1	150.5	160.7	167.0
Ex. social ins. funds		18.3	19.7	27.9	37.0	52.2	66.0	82.9	92.8	99.1
Gross natl. saving rate	%	14.5	14.4	15.5	16.3	16.6	17.4	17.4	17.0	16.7
Net natl. saving rate		3.7	3.7	4.7	5.8	6.3	7.3	7.4	7.2	6.9
PRICES AND COSTS										
GDP chn.-wt. price index	% change	2.6	2.6	2.5	2.1	1.8	1.7	0.9	1.5	1.9
Gross Domestic Purchases chn.-wt. price index		2.7	2.3	2.5	2.0	1.8	1.3	0.4	1.4	1.7
CPI		3.1	2.7	2.6	2.7	3.1	1.9	1.5	2.2	2.4
Ex. food and energy		3.5	3.1	2.8	3.1	2.6	2.2	2.4	2.1	2.5
ECI, hourly compensation[2]		3.5	3.6	3.1	2.6	3.1	3.4	3.5	3.4	3.5
Nonfarm business sector										
Output per hour		3.5	-0.4	0.1	1.3	2.0	1.5	2.7	1.8	1.7
Compensation per Hour		4.5	1.6	2.1	2.9	3.6	3.7	4.0	3.8	4.0
Unit labor cost		1.0	2.0	2.0	1.6	1.6	2.1	1.3	2.0	2.3

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

Strictly Confidential <FR> Class II FOMC

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

March 24, 1999

Item	Units	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2
EXPENDITURES											
Nominal GDP	Bill. $	7495.3	7629.2	7703.4	7818.4	7955.0	8063.4	8170.8	8254.5	8384.2	8440.6
Real GDP	Bill. Ch. $	6882.0	6983.9	7020.0	7093.1	7166.7	7236.5	7311.2	7364.6	7464.7	7498.6
Real GDP	% change	3.3	6.1	2.1	4.2	4.2	4.0	4.2	3.0	5.5	1.8
Gross domestic purchases		4.5	7.0	3.4	1.8	5.5	4.4	4.6	3.2	7.8	3.9
Final sales		3.6	5.4	0.9	5.1	2.9	2.7	5.8	2.1	4.3	4.6
Priv. dom. final purchases		5.1	6.2	2.8	3.3	4.6	3.3	7.5	2.9	8.5	7.4
Personal cons. expenditures		3.7	4.7	1.8	2.9	4.3	1.6	6.2	2.8	6.1	6.1
Durables		5.8	12.7	-1.9	7.2	12.3	-1.5	16.8	3.1	15.8	11.2
Nondurables		2.2	4.8	1.2	2.9	3.6	-0.2	5.1	-0.4	7.4	5.3
Services		4.0	3.0	3.0	2.0	3.1	3.2	4.7	4.3	3.5	5.4
Business fixed investment		13.1	11.0	14.2	8.8	7.0	14.0	17.0	1.8	22.2	12.8
Producers' dur. equipment		15.7	12.3	16.2	3.2	8.3	22.8	18.8	2.2	34.3	18.8
Nonres. structures		6.4	7.4	8.9	24.5	3.9	-6.2	12.4	0.9	-4.9	-2.3
Residential structures		9.3	19.5	-1.7	-3.9	3.1	6.1	-0.4	8.2	15.6	15.0
Exports		3.7	5.8	2.1	32.0	8.3	15.5	10.6	4.4	-2.8	-7.7
Imports		13.1	13.5	13.6	7.0	18.6	17.9	13.5	6.3	15.7	9.3
Gov't. cons. & investment		3.2	7.1	-1.6	0.0	2.1	2.1	1.4	0.1	-1.9	3.7
Federal		8.0	8.1	-4.7	-6.3	-2.7	3.6	-1.2	-2.1	-8.8	7.3
Defense		7.2	8.1	-6.3	-8.3	-9.9	9.1	-1.8	-2.0	-18.5	9.9
State & local		0.5	6.5	0.3	3.8	4.9	1.3	2.9	1.3	2.1	1.8
Change in bus. inventories	Bill. Ch. $	14.4	26.1	47.5	32.1	56.3	79.0	51.0	66.5	91.4	38.2
Nonfarm		10.4	15.2	38.6	28.7	56.2	72.1	44.0	62.7	85.9	29.9
Net exports		-95.5	-113.5	-140.1	-95.9	-121.5	-131.6	-142.4	-149.0	-198.5	-245.2
Nominal GDP	% change	5.7	7.3	3.9	6.1	7.2	5.6	5.4	4.2	6.4	2.7
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	118.5	119.3	120.0	120.7	121.5	122.3	123.0	123.9	124.8	125.5
Unemployment rate	%	5.5	5.5	5.3	5.3	5.2	5.0	4.9	4.7	4.6	4.4
Industrial prod. index	% change	2.8	9.6	5.5	3.5	6.6	6.0	7.2	6.6	1.6	2.8
Capacity util. rate - mfg.	%	80.9	81.6	81.8	81.3	81.6	81.7	82.1	82.5	81.8	81.2
Housing starts	Millions	1.46	1.50	1.50	1.42	1.46	1.47	1.46	1.52	1.59	1.57
Light motor vehicle sales		15.10	15.18	15.00	14.91	15.32	14.54	15.19	15.02	15.08	16.07
North Amer. produced		13.44	13.46	13.33	13.16	13.41	12.68	13.20	13.08	13.13	14.07
Other		1.66	1.72	1.68	1.76	1.92	1.86	1.99	1.94	1.95	1.99
INCOME AND SAVING											
Nominal GNP	Bill. $	7515.0	7643.3	7708.6	7829.0	7952.4	8062.3	8162.0	8234.9	8369.4	8421.8
Nominal GNP	% change	5.6	7.0	3.5	6.4	6.5	5.6	5.0	3.6	6.7	2.5
Nominal personal income		6.6	6.9	5.5	4.6	7.3	4.7	4.7	5.0	5.9	4.5
Real disposable income		2.9	2.1	4.4	1.3	3.3	2.9	2.4	2.9	4.0	2.6
Personal saving rate	%	3.2	2.6	3.1	2.6	2.4	2.6	1.7	1.7	1.2	0.4
Corp. profits, IVA & CCAdj.	% change	16.9	6.9	3.8	3.5	18.1	11.1	13.1	-9.2	4.2	-4.1
Profit share of GNP	%	9.8	9.8	9.8	9.7	10.0	10.1	10.3	10.0	9.9	9.7
Excluding FR Banks		9.5	9.5	9.5	9.5	9.7	9.8	10.0	9.7	9.6	9.5
Federal surpl./deficit	Bill. $	-150.1	-112.6	-100.1	-78.3	-51.2	-34.8	-0.3	2.2	58.8	74.4
State & local surpl./def.		117.3	129.1	122.3	121.7	128.4	130.1	136.6	141.4	140.2	141.3
Ex. social ins. funds		45.3	58.2	52.5	52.9	59.8	61.6	68.7	73.8	72.7	73.6
Gross natl. saving rate	%	16.4	16.4	16.8	16.7	17.0	17.6	17.5	17.3	17.7	17.2
Net natl. saving rate		6.0	6.2	6.6	6.5	7.0	7.6	7.5	7.3	7.8	7.2
PRICES AND COSTS											
GDP chn.-wt. price index	% change	2.2	1.4	1.8	1.6	2.8	1.7	1.2	1.1	0.9	0.9
Gross Domestic Purchases chn.-wt. price index		2.1	1.4	1.5	2.1	2.2	0.9	1.1	1.0	-0.2	0.4
CPI		3.2	3.7	2.6	3.3	2.0	1.5	1.8	2.3	0.5	2.0
Ex. food and energy		2.5	2.5	2.7	2.7	2.2	2.6	1.9	2.1	2.4	2.6
ECI, hourly compensation[1]		2.5	3.5	2.8	2.8	2.5	3.7	3.4	4.3	2.7	3.6
Nonfarm business sector											
Output per hour		4.2	3.0	-0.1	1.0	0.1	1.6	3.4	0.9	3.6	0.3
Compensation per hour		2.7	5.2	3.6	3.1	3.7	2.4	3.8	4.9	4.7	4.1
Unit labor cost		-1.5	2.2	3.7	2.1	3.5	0.7	0.3	4.0	1.1	3.7

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)

March 24, 1999

			Projected								
Item	Units	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4
EXPENDITURES											
Nominal GDP	Bill. $	8537.9	8678.7	8787.6	8887.8	8972.0	9071.4	9133.2	9253.8	9345.5	9439.2
Real GDP	Bill. Ch. $	7566.5	7676.5	7741.7	7802.6	7847.9	7906.6	7919.5	7990.0	8032.7	8076.7
Real GDP	% change	3.7	5.9	3.4	3.2	2.3	3.0	0.7	3.6	2.2	2.2
Gross domestic purchases		4.2	5.4	5.4	4.4	3.2	3.3	1.3	4.2	2.6	2.2
Final sales		2.8	6.4	3.8	2.5	2.4	3.0	1.5	3.2	2.2	2.5
Priv. dom. final purchases		3.7	6.3	6.7	4.1	3.6	3.7	2.1	3.9	2.8	2.8
Personal cons. expenditures		4.1	4.6	6.0	4.1	4.0	4.2	2.0	4.0	2.6	2.4
Durables		2.4	20.2	12.7	2.6	5.0	5.3	3.9	3.4	3.7	3.6
Nondurables		2.1	4.3	7.0	4.8	4.6	5.1	0.5	4.2	2.6	2.0
Services		5.4	1.7	4.2	4.1	3.5	3.5	2.4	4.0	2.4	2.3
Business fixed investment		-0.7	15.8	9.1	6.7	4.7	4.0	4.5	6.9	6.9	7.6
Producers' dur. equipment		-1.0	19.0	12.4	9.4	6.4	5.3	6.1	9.1	9.2	9.8
Nonres. structures		0.2	7.4	0.3	-0.4	-0.1	0.3	-0.1	0.8	0.6	1.4
Residential structures		9.9	10.6	11.6	-1.3	-4.7	-3.7	-2.8	-3.6	-3.2	-2.3
Exports		-2.8	19.0	-7.6	-0.1	1.7	4.3	0.3	3.8	4.8	7.2
Imports		2.3	12.0	8.6	10.0	8.5	6.5	5.6	8.3	8.0	5.8
Gov't. cons. & investment		1.5	3.3	1.4	2.0	1.8	1.4	2.3	2.9	1.7	1.0
Federal		-1.4	7.3	-5.1	0.5	-1.1	-2.1	0.3	2.1	-1.4	-3.4
Defense		4.3	1.3	-7.9	1.1	-1.6	-2.0	-1.4	-1.2	-0.1	0.2
State & local		3.1	1.4	5.2	2.8	3.3	3.3	3.4	3.3	3.4	3.4
Change in bus. inventories	Bill. Ch. $	55.7	47.8	40.2	53.7	52.5	53.4	36.4	45.9	46.0	39.6
Nonfarm		47.0	40.7	34.2	49.2	49.3	51.5	34.8	44.3	44.6	38.4
Net exports		-259.0	-251.4	-297.1	-328.4	-351.4	-362.3	-380.3	-398.8	-414.2	-416.8
Nominal GDP	% change	4.7	6.8	5.1	4.6	3.8	4.5	2.8	5.4	4.0	4.1
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	126.1	126.8	127.6	128.3	128.8	129.3	129.7	130.4	130.5	130.6
Unemployment rate	%	4.5	4.4	4.3	4.2	4.2	4.2	4.3	4.3	4.4	4.5
Industrial prod. index	% change	0.9	2.2	1.3	3.9	4.5	4.6	-0.0	2.4	2.5	2.7
Capacity util. rate - mfg.	%	80.2	80.1	79.5	79.6	79.9	80.3	79.8	79.8	79.9	80.0
Housing starts	Millions	1.64	1.70	1.75	1.64	1.62	1.61	1.59	1.57	1.56	1.55
Light motor vehicle sales		14.55	16.31	16.21	15.71	15.46	15.32	15.15	15.02	14.99	15.01
North Amer. produced		12.54	14.11	13.93	13.53	13.33	13.26	13.14	13.06	13.06	13.07
Other		2.01	2.20	2.28	2.18	2.13	2.06	2.01	1.96	1.93	1.94
INCOME AND SAVING											
Nominal GNP	Bill. $	8510.9	8657.2	8754.9	8850.2	8927.9	9020.3	9078.8	9196.5	9285.7	9376.2
Nominal GNP	% change	4.3	7.1	4.6	4.4	3.6	4.2	2.6	5.3	3.9	4.0
Nominal personal income		4.5	5.3	5.8	4.9	4.6	4.7	5.2	4.7	4.0	4.2
Real disposable income		3.2	4.2	5.6	2.6	2.5	2.7	4.1	2.6	1.8	2.0
Personal saving rate	%	0.2	0.1	-0.1	-0.4	-0.7	-1.1	-0.5	-0.8	-1.0	-1.0
Corp. profits, IVA & CCAdj.	% change	3.2	12.9	0.2	-4.5	-5.8	-0.9	-9.8	8.4	2.3	1.7
Profit share of GNP	%	9.7	9.8	9.7	9.5	9.3	9.2	8.9	9.0	8.9	8.9
Excluding FR Banks		9.4	9.6	9.5	9.2	9.0	8.9	8.6	8.7	8.7	8.6
Federal surpl./deficit	Bill. $	92.0	76.1	116.9	141.7	161.4	172.2	163.5	181.9	197.0	205.2
State & local surpl./def.		148.7	171.8	160.1	160.0	159.2	163.7	165.8	168.1	167.9	166.3
Ex. social ins. funds		81.3	103.9	92.2	92.1	91.3	95.8	97.9	100.2	100.0	98.4
Gross natl. saving rate	%	17.3	17.3	17.4	17.1	16.9	16.7	16.7	16.7	16.7	16.7
Net natl. saving rate		7.3	7.4	7.5	7.3	7.0	6.8	6.9	6.9	6.9	6.9
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.0	0.8	1.6	1.4	1.5	1.4	2.1	1.7	1.8	1.8
Gross Domestic Purchases chn.-wt. price index		0.7	0.8	1.2	1.6	1.4	1.4	2.0	1.6	1.6	1.7
CPI		1.7	2.0	1.6	2.8	2.3	2.2	2.3	2.4	2.4	2.4
Ex. food and energy		2.3	2.3	1.7	2.0	2.2	2.3	2.5	2.5	2.6	2.6
ECI, hourly compensation[1]		4.4	2.9	3.1	3.4	3.4	3.5	3.4	3.5	3.5	3.8
Nonfarm business sector											
Output per hour		2.5	4.5	2.9	1.9	1.0	1.4	-0.3	3.0	2.1	2.1
Compensation per hour		3.9	3.5	4.1	3.7	3.7	3.7	4.1	3.8	3.8	4.2
Unit labor cost		1.4	-1.1	1.2	1.8	2.7	2.3	4.4	0.8	1.7	2.1

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	96Q4/ 95Q4	97Q4/ 96Q4	98Q4/ 97Q4
Real GDP	2.1	4.2	4.2	4.0	4.2	3.0	5.5	1.8	3.7	3.9	3.8	4.2
Gross dom. purchases	3.5	1.9	5.5	4.4	4.7	3.2	7.9	4.0	4.3	4.2	4.4	5.4
Final sales	0.9	5.1	2.9	2.7	5.7	2.1	4.3	4.6	2.8	3.7	3.3	4.5
Priv. dom. final purchases	2.3	2.7	3.8	2.7	6.1	2.4	7.0	6.1	3.1	3.6	3.8	5.3
Personal cons. expenditures	1.3	2.0	2.9	1.1	4.2	1.9	4.1	4.1	2.8	2.2	2.5	3.5
Durables	-0.2	0.6	1.0	-0.1	1.3	0.3	1.2	0.9	0.2	0.5	0.6	1.0
Nondurables	0.2	0.6	0.7	-0.0	1.0	-0.1	1.4	1.0	0.4	0.6	0.4	0.9
Services	1.2	0.8	1.2	1.3	1.9	1.7	1.4	2.1	2.2	1.2	1.5	1.6
Business fixed investment	1.4	0.9	0.7	1.4	1.7	0.2	2.2	1.4	-0.1	1.2	1.0	1.3
Producers' dur. equip.	1.1	0.2	0.6	1.6	1.3	0.1	2.4	1.4	-0.1	0.8	0.9	1.3
Nonres. structures	0.2	0.6	0.1	-0.2	0.4	0.0	-0.2	-0.1	0.0	0.3	0.1	0.0
Residential structures	-0.1	-0.2	0.1	0.2	-0.0	0.3	0.6	0.6	0.4	0.2	0.2	0.5
Net exports	-1.3	2.4	-1.2	-0.5	-0.5	-0.3	-2.2	-2.1	-0.6	-0.3	-0.6	-1.1
Exports	0.2	3.2	1.0	1.8	1.2	0.5	-0.3	-0.9	-0.3	1.2	1.1	0.1
Imports	-1.6	-0.9	-2.2	-2.2	-1.7	-0.8	-1.9	-1.2	-0.3	-1.4	-1.7	-1.2
Government cons. & invest.	-0.3	0.0	0.4	0.4	0.3	0.0	-0.3	0.6	0.3	0.4	0.3	0.3
Federal	-0.3	-0.4	-0.2	0.2	-0.1	-0.1	-0.6	0.4	-0.1	0.1	-0.0	0.1
Defense	-0.3	-0.4	-0.5	0.4	-0.1	-0.1	-0.8	0.4	0.2	-0.0	-0.1	-0.1
Nondefense	0.0	0.0	0.3	-0.2	0.0	-0.1	0.3	0.1	-0.3	0.1	0.0	0.1
State and local	0.0	0.4	0.6	0.2	0.3	0.2	0.2	0.2	0.4	0.3	0.3	0.2
Change in bus. inventories	1.2	-0.8	1.3	1.3	-1.4	0.9	1.2	-2.7	0.9	0.2	0.5	-0.2
Nonfarm	1.3	-0.5	1.5	0.9	-1.5	1.0	1.2	-2.8	0.9	0.1	0.5	-0.3
Farm	-0.1	-0.3	-0.2	0.4	0.1	-0.1	0.0	0.1	0.0	0.0	0.0	0.1

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	98Q4/ 97Q4	99Q4/ 98Q4	0Q4/ 99Q4
Real GDP	5.9	3.4	3.2	2.3	3.0	0.7	3.6	2.2	2.2	4.2	3.0	2.2
Gross dom. purchases	5.5	5.5	4.5	3.3	3.4	1.4	4.3	2.7	2.3	5.4	4.1	2.7
Final sales	6.3	3.8	2.5	2.4	3.0	1.4	3.2	2.1	2.5	4.5	2.9	2.3
Priv. dom. final purchases	5.3	5.6	3.5	3.0	3.1	1.8	3.3	2.4	2.4	5.3	3.8	2.5
Personal cons. expenditures	3.1	4.1	2.8	2.7	2.9	1.4	2.8	1.8	1.6	3.5	3.1	1.9
Durables	1.6	1.0	0.2	0.4	0.4	0.3	0.3	0.3	0.3	1.0	0.5	0.3
Nondurables	0.8	1.3	0.9	0.9	1.0	0.1	0.8	0.5	0.4	0.9	1.0	0.5
Services	0.7	1.7	1.6	1.4	1.4	1.0	1.6	1.0	0.9	1.6	1.5	1.1
Business fixed investment	1.6	1.0	0.7	0.5	0.4	0.5	0.7	0.7	0.8	1.3	0.7	0.7
Producers' dur. equip.	1.4	1.0	0.7	0.5	0.4	0.5	0.7	0.7	0.8	1.3	0.7	0.7
Nonres. structures	0.2	0.0	-0.0	-0.0	0.0	-0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residential structures	0.5	0.5	-0.1	-0.2	-0.2	-0.1	-0.2	-0.1	-0.1	0.5	0.0	-0.1
Net exports	0.5	-2.0	-1.3	-0.9	-0.4	-0.7	-0.7	-0.6	-0.0	-1.1	-1.1	-0.5
Exports	2.0	-0.9	-0.0	0.2	0.5	0.0	0.4	0.5	0.7	0.1	-0.1	0.4
Imports	-1.5	-1.1	-1.3	-1.1	-0.9	-0.7	-1.1	-1.1	-0.8	-1.2	-1.1	-0.9
Government cons. & invest.	0.6	0.2	0.3	0.3	0.2	0.4	0.5	0.3	0.2	0.3	0.3	0.3
Federal	0.4	-0.3	0.0	-0.1	-0.1	0.0	0.1	-0.1	-0.2	0.1	-0.1	-0.0
Defense	0.1	-0.3	0.0	-0.1	-0.1	-0.1	-0.0	-0.0	0.0	-0.1	-0.1	-0.0
Nondefense	0.4	0.0	-0.0	-0.0	-0.0	0.1	0.2	-0.1	-0.2	0.1	-0.0	-0.0
State and local	0.2	0.6	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.2	0.4	0.4
Change in bus. inventories	-0.4	-0.4	0.6	-0.1	0.0	-0.8	0.4	0.0	-0.3	-0.2	0.1	-0.2
Nonfarm	-0.3	-0.3	0.7	0.0	0.1	-0.8	0.4	0.0	-0.3	-0.3	0.1	-0.2
Farm	-0.1	-0.1	-0.1	-0.1	-0.1	-0.0	-0.0	-0.0	-0.0	0.1	-0.1	-0.0

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

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

Item	Fiscal year[4]				1998				1999				2000			
	1997[a]	1998[a]	1999	2000	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1579	1722	1821	1908	378	544	412	413	394	570	444	431	426	590	461	447
Outlays[1]	1601	1653	1698	1739	409	407	409	468	392	421	418	441	445	433	420	451
Surplus/deficit[1]	-22	69	122	169	-30	137	3	-55	2	149	26	-10	-19	157	41	-4
On-budget	-103	-30	-7	26	-53	87	3	-58	-51	94	9	-49	-43	96	22	-45
Off-budget	81	99	129	143	22	50	0	3	54	56	17	39	24	62	18	41
Surplus excluding deposit insurance	-36	65	118	165	-31	136	2	-57	2	148	25	-11	-19	156	40	-5
Means of financing																
Borrowing	38	-51	-94	-160	26	-82	-29	32	11	-120	-18	0	13	-125	-48	-9
Cash decrease	1	5	-1	0	4	-45	33	21	-3	-20	0	10	10	-25	5	20
Other[2]	-17	-23	-27	-9	0	-10	-8	1	-10	-10	-9	1	-4	-7	2	-7
Cash operating balance, end of period	44	39	40	40	28	72	39	18	21	40	40	30	20	45	40	20
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1687	1818	1923	2016	1809	1838	1859	1881	1911	1939	1962	1989	1998	2027	2048	2070
Expenditures	1728	1761	1799	1837	1750	1764	1767	1804	1794	1797	1800	1817	1835	1845	1851	1865
Consumption expend.	458	458	472	483	451	464	459	471	472	473	473	471	483	488	487	484
Defense	306	301	306	310	293	303	303	307	305	307	306	305	311	311	312	313
Nondefense	152	157	166	173	158	161	156	164	166	166	167	166	172	177	175	171
Other expenditures	1270	1303	1327	1354	1299	1300	1308	1333	1322	1324	1328	1345	1351	1357	1364	1381
Current account surplus	-41	57	124	179	59	74	92	78	117	142	161	172	164	182	197	205
Gross investment	61	60	59	58	61	57	61	60	59	59	59	58	58	58	58	58
Current and capital account surplus	-102	-3	65	121	-2	18	31	18	58	83	103	114	106	124	139	147
FISCAL INDICATORS[3]																
High-employment (HEB) surplus/deficit	-161	-99	-69	-15	-100	-83	-74	-107	-74	-57	-38	-30	-26	-12	7	20
Change in HEB, percent of potential GDP	-.8	-.8	-.4	-.6	-.5	-.2	-.1	.4	-.4	-.2	-.2	-.1	0	-.2	-.2	-.1
Fiscal impetus (FI), percent, cal. year	-2.1	-1.7	1.7	-.9	-2.1	1.1	.4	.9	1	.1	-.6	-.8	0	.5	-.4	-1

1. OMB's February 1999 surplus estimates (assuming the enactment of the President's proposals) are $69 billion in FY98, $79 billion in FY99 and $103 billion in FY2000. CBO's March 1999 baseline surplus estimates are $111 billion in FY99 and $133 billion in FY2000. 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. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.

3. 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 be 2.8 percent beginning 1996:Q2. *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.

4. 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: Nominal GDP
				Households					
			Total[4]	Total	Home mortgages	Consumer credit	Business	State and local governments	
Year									
1990	6.4	11.0	5.2	7.5	9.6	1.5	3.1	5.0	4.4
1991	4.3	11.1	2.3	4.7	6.4	-1.3	-1.7	8.6	3.8
1992	4.6	10.9	2.6	4.3	5.2	0.5	0.8	2.2	6.3
1993	5.0	8.3	3.8	5.3	4.3	7.6	1.5	6.0	5.0
1994	4.6	4.7	4.6	7.6	5.8	14.5	4.1	-4.0	5.8
1995	5.4	4.1	5.9	7.8	5.6	14.1	6.7	-4.6	4.2
1996	5.2	4.0	5.7	7.5	7.7	7.9	5.3	-0.6	5.8
1997	5.1	0.6	6.7	6.5	6.8	4.3	7.3	5.3	5.6
1998	6.3	-1.4	8.8	8.9	9.9	5.4	9.2	7.2	5.1
1999	5.1	-3.4	7.7	8.3	9.1	5.7	7.5	5.3	4.5
2000	4.2	-4.7	6.6	7.2	7.9	3.8	6.4	4.8	4.1
Quarter									
1997:3	5.6	0.8	7.3	6.9	9.1	4.1	7.7	6.7	5.4
4	5.7	1.1	7.3	5.6	5.5	3.0	9.0	8.4	4.2
1998:1	6.0	-0.8	8.2	8.0	9.8	4.5	8.4	8.4	6.4
2	6.0	-1.9	8.6	8.2	8.2	5.1	9.4	6.9	2.7
3	5.5	-3.6	8.4	7.9	9.0	6.4	9.3	6.2	4.7
4	7.1	0.7	9.0	10.2	11.1	5.1	8.3	6.4	6.8
1999:1	5.5	-2.8	8.0	8.7	9.3	6.6	7.8	5.4	5.1
2	4.9	-4.5	7.7	8.3	9.0	5.9	7.5	5.3	4.6
3	5.0	-3.4	7.3	7.8	8.7	5.2	7.3	5.2	3.8
4	4.7	-3.0	6.8	7.4	8.3	4.5	6.6	5.0	4.5

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 1998:Q4 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 is estimated to have grown 6.1 percent in 1998 and is projected to grow 5.4 percent in 1999 and 4.3 percent in 2000.

3. On a monthly average basis, federal debt is estimated to have grown -1.2 percent in 1998 and is projected to grow -2.9 percent in 1999 and -4.5 percent in 2000.

4. On a monthly average basis, nonfederal debt is estimated to have grown 8.6 percent in 1998 and is projected to grow 7.9 percent in 1999 and 6.7 percent in 2000.

2.6.3 FOF

Strictly Confidential Class II FOMC
March 24, 1999

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

Category	Calendar year				Seasonally adjusted annual rates									
					1998				1999				2000	
	1997	1998	1999	2000	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	H1	H2
Net funds raised by domestic nonfinancial sectors														
1 Total	622.4	688.2	698.3	638.5	765.5	796.3	547.1	643.9	832.8	766.3	616.7	577.7	666.9	610.0
2 Net equity issuance	-114.4	-262.8	-123.0	-75.0	-139.2	-129.1	-308.4	-474.4	-52.0	-32.0	-204.0	-204.0	-80.0	-70.0
3 Net debt issuance	736.9	950.9	821.3	713.5	904.7	925.4	855.5	1118.3	884.8	798.3	820.7	781.7	746.9	680.0
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	62.7	78.5	124.8	156.6	102.8	78.2	67.5	65.5	83.9	121.8	141.1	152.4	149.1	164.0
5 Net equity issuance	-114.4	-262.8	-123.0	-75.0	-139.2	-129.1	-308.4	-474.4	-52.0	-32.0	-204.0	-204.0	-80.0	-70.0
6 Credit market borrowing	324.1	438.2	390.6	358.4	402.9	460.1	466.6	423.3	404.8	398.2	394.7	364.7	357.6	359.1
Households														
7 Net borrowing [2]	333.6	485.0	493.7	463.8	437.5	457.2	452.7	592.7	519.1	503.2	486.4	466.3	472.9	454.7
8 Home mortgages	236.7	368.9	374.2	354.3	365.4	312.4	353.2	444.6	383.1	378.4	372.9	362.2	358.6	350.0
9 Consumer credit	52.5	67.9	75.5	53.5	57.0	64.8	83.4	66.6	87.9	79.9	71.4	62.6	55.9	51.2
10 Debt/DPI (percent) [3]	91.5	94.8	97.9	100.8	93.1	94.1	95.0	96.0	96.6	97.6	98.5	99.3	100.1	101.6
State and local governments														
11 Net borrowing	56.1	80.3	63.7	60.8	94.3	78.9	72.6	75.4	65.0	64.5	63.5	62.0	59.8	61.8
12 Current surplus [4]	135.6	183.0	193.2	201.2	179.1	169.4	182.7	200.7	192.2	186.7	194.5	199.6	201.3	201.2
Federal government														
13 Net borrowing	23.1	-52.6	-126.7	-169.4	-30.0	-70.9	-136.5	26.9	-104.0	-167.5	-123.8	-111.2	-143.3	-195.5
14 Net borrowing (quarterly, n.s.a.)	23.1	-52.6	-126.7	-169.4	25.9	-81.8	-28.8	32.1	11.3	-120.0	-17.6	-0.4	-112.4	-57.0
15 Unified deficit (quarterly, n.s.a.)	2.4	-54.7	-167.2	-175.3	30.2	-136.9	-3.0	55.0	-2.2	-149.4	-25.8	10.3	-138.6	-36.7
Depository institutions														
16 Funds supplied	336.3	364.3	286.0	292.1	319.5	156.9	296.9	683.9	237.5	308.1	317.7	280.4	291.9	292.4
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	182.6	183.9	185.2	186.2	182.4	183.9	184.4	184.2	184.8	185.1	185.6	185.8	186.4	186.3
18 Domestic nonfinancial borrowing	9.1	11.2	9.2	7.7	10.8	11.0	10.0	12.9	10.1	9.0	9.1	8.6	8.1	7.2
19 Federal government [6]	0.3	-0.6	-1.4	-1.8	-0.4	-0.8	-1.6	0.3	-1.2	-1.9	-1.4	-1.2	-1.6	-2.1
20 Nonfederal	8.8	11.8	10.6	9.5	11.1	11.8	11.6	12.6	11.3	10.9	10.5	9.8	9.7	9.3

Note. Data after 1998:Q4 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.

International Developments

The upward revision to our near-term projection for U.S. domestic demand combined with the assumption of a higher path for the dollar has led us to raise our projection for real imports from that in the January Greenbook. We also anticipate that real export growth will be slowed by the stronger U.S. dollar, although this effect is partly offset by a slightly more optimistic view of foreign growth. The higher path for the dollar results in less core non-oil import price inflation, but we expect slightly higher oil prices than we did in January.

Latin American financial markets calmed in recent weeks, and contagion from Brazil's problems has been more limited than we expected, so we have revised upward somewhat our forecast for growth in Latin America. In Asia, economic activity in the emerging market economies hit by earlier crises seems to have bottomed out and, in some cases, even returned to an upward growth path. However, there is still little or no evidence of economic recovery in Japan, and the Bank of Japan has eased monetary policy further. In Europe, the latest economic indicators are mixed but, on balance, point to continued sluggish growth. However, the European Central Bank has resisted pressures to lower interest rates, despite virtually non-existent inflation.

Recent Developments

International financial markets. During the period since the February FOMC meeting, the dollar has appreciated about 1-1/2 percent on a weighted-average basis against a broad group of currencies.[1] Most of this gain came against the major foreign currencies, including gains of 4-1/2 percent against the yen and 3-1/2 percent against the euro. The dollar was boosted by signs that U.S. economic activity remained brisk, in contrast to recent evidence that economic activity in most other major industrial countries slowed or contracted. Also supporting the dollar was an increase in the yield differential between U.S. and foreign long-term bonds. The differential between the yield on U.S. ten-year Treasuries and the weighted-average foreign ten-year interest rate rose about 35 basis points. The yield on ten-year Japanese government bonds fell 50 basis points, to about 1.75 percent, against a backdrop of abundant liquidity injections by the Bank of Japan. In contrast, long-term interest rates in the euro area have increased about 30 basis points, despite evidence of weakening economic activity, which continued to stoke market expectations that the European Central Bank may soon ease policy.

The dollar changed little, on average, against the currencies of other important U.S. trading partners. Pressures on the Brazilian *real* abated recently. After a

1. The broad index for the dollar includes the seven major international currencies that are in the major currencies index as well as the currencies of nineteen other important U.S. trading partners.

rough patch in late February, the currency recovered to a level about 35 percent below its pre-floating peg. Following the confirmation of Arminio Fraga as its new president, Brazil's central bank raised its overnight interest rate from 39 percent to 45 percent. The currency was also supported by the agreement reached with the IMF that paves the way for the receipt of the second tranche of international assistance later this month and by the completion of the major legislative elements of the fiscal reform program. On balance, the dollar appreciated about 2 percent against the *real* during the intermeeting period. In contrast, the dollar depreciated about 4 percent against the Mexican peso as confidence in the Mexican economy improved with the rebound in oil prices and diminished worries about pressures emanating from Brazil. Yield spreads for Brazilian Brady bonds narrowed more than 200 basis points, and those of most other Latin American countries also declined.

The Desk did not intervene for the accounts of the System or the Treasury during the intermeeting period.

Economic activity abroad. Most of the economies of the major foreign industrial countries faltered in the fourth quarter of 1998. In Japan, real GDP contracted for the fifth consecutive quarter, and data for early 1999 provide scant evidence of recovery. In the euro area, real GDP growth slowed sharply in the fourth quarter as output contracted in Germany and Italy but grew moderately in France. The limited information available for the current quarter suggests that, although consumer confidence has continued to improve and unemployment rates have edged down, both domestic and export orders have weakened substantially. Economic activity has continued to grow at a tepid pace in the United Kingdom. In contrast, Canadian real GDP growth rebounded sharply in the fourth quarter from its slow pace earlier in the year, and recent indicators suggest a further upswing in employment, production, and sales.

There continue to be no signs of inflationary pressure in foreign industrial countries. In Japan, evidence of deflation has mounted; in February, the consumer price index registered a small twelve-month decline while wholesale prices were well below their year-earlier level. In January and February, Canadian inflation fell below 1 percent, the lower bound of the Bank of Canada's target range. Twelve-month consumer price inflation in the euro area has remained below 1 percent, while French and German inflation has been close to nil.

Economic activity in Latin America continued to weaken as heightened uncertainty and high interest rates took their toll. In Brazil, real GDP fell at a 6 percent annual rate in the fourth quarter, about the same decline as in the previous quarter. Consumer price inflation, which had fallen to quite low levels late last year, rose sharply to about 13 percent (annual rate) in January and 20 percent in February, but receded somewhat in March, according to the latest weekly data. Growth came to a standstill in Mexico in the fourth quarter after several quarters of expansion. The latest monthly data suggest that the Mexican economy is still sluggish. Mexican inflation moved down slightly in February to a twelve-month rate of 18-1/2 percent. In the fourth quarter, Argentine real GDP fell about 6 percent (annual rate) for the second consecutive quarter, and in January, industrial production continued to be depressed. Inflation fell to zero in February. Argentina's currency peg to the dollar was maintained as active discussion of dollarization continued.

There are indications that economic recovery is taking hold in Korea. Real GDP grew strongly in the fourth quarter, and in January, industrial production was well above its year-earlier level. However, the unemployment rate rose to a record high near 9 percent in February, putting further downward pressure on consumer prices, which showed little increase from a year ago. Economic activity may be bottoming out in other ASEAN countries, and inflation rates in these countries came down slightly in recent months, mainly reflecting weak domestic demand. In China, increased investment by state-owned enterprises boosted growth in the fourth quarter, but deflation has continued. External demand remained weak; the value of Chinese exports in January and February was 10 percent below the year-earlier level. The Russian economy continued to deteriorate, with output falling almost 10 percent during 1998, and inflation soaring to a twelve-month rate above 100 percent in February. The status of Russia's IMF program remains unresolved.

U.S. net exports and prices. In January, the U.S. nominal trade deficit in goods and services widened to $17 billion, a level substantially above the deficits in the previous four months. Exports declined for the third month in a row while imports reversed most of the previous month's drop. About half of the decrease in exports was accounted for by agricultural products. Exports of automotive parts (to countries outside of North America), chemicals, and machinery (other than computers and semi-conductors) also fell. The January level of total U.S. exports was about 3 percent below the fourth-quarter average (not at an annual rate). Exports to countries in Asia slipped from December peaks that were boosted by aircraft deliveries. Reflecting strong domestic demand, imports rose 2 percent, almost reversing December's decline. About a quarter of the increase in imports was accounted for by consumer goods. Oil imports were about unchanged, as a decline in the price of imported oil was offset by an increase in the volume. In January, imports stood 3 percent above their fourth-quarter average level.

The average spot price of WTI crude oil fell nearly $.50 in February to about $12.00 per barrel as slower foreign economic activity and unseasonably warm weather depressed demand, and supply from Iran and Iraq continued to exceed expectations, resulting in higher inventories. Subsequently, the spot WTI price increased more than $3 per barrel in anticipation of supply cuts from major oil producers, who announced plans to reduce oil supply by 2 million barrels per day. On March 23, these plans were ratified at an OPEC meeting, and spot WTI closed at $15.34 per barrel.

Prices of non-oil imports fell slightly in February after rising in January. Core import prices (excluding oil, agricultural products, computers, and semiconductors) followed a similar pattern; increases in prices of capital goods (excluding computers and semiconductors), automotive products, and consumer goods were partially offset by declines for foods. Export prices declined a bit in February after essentially no change in January.

The U.S. current account deficit narrowed slightly in the fourth quarter owing to an improvement in the trade balance and a smaller deficit for investment income. For 1998 as a whole, the deficit increased to $233 billion, amounting to 2.7 percent of GDP.

Outlook

We project that declines in U.S. real net exports will amount to about 1 percentage point of U.S. growth in 1999 and about 1/2 percentage point of growth in 2000. Import growth is higher than in the previous Greenbook, because of the upward revision to projected U.S. income growth in the near term and the higher path for the dollar. We also expect the stronger dollar to slow the pace of export growth, but an upward revision to the foreign growth outlook works in the opposite direction, leaving export growth only a bit lower than in the previous forecast.

The staff expects foreign real GDP (weighted by U.S. nonagricultural export shares) to continue to grow at an annual rate of about 1 percent during the first half of 1999. Total foreign growth is projected to increase to an annual rate of about 1-3/4 percent in the second half of this year and to 2-1/2 percent during 2000. This forecast is about one-half percentage point stronger than that projected in the previous Greenbook for this year and about one-quarter percentage point stronger for 2000.

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

Measure	1998		Projection		
			1999		2000
	H1	H2	H1	H2	
Foreign output	-.1	1.1	.9	1.7	2.4
January GB	*-.1*	*1.0*	*.4*	*1.3*	*2.2*
Real exports	-5.3	7.6	-3.9	3.0	4.0
January GB	*-5.3*	*7.1*	*-3.0*	*3.5*	*4.4*
Real imports	12.5	7.1	9.3	7.5	6.9
January GB	*12.5*	*8.3*	*5.7*	*6.5*	*6.7*

The dollar. We project that the trade-weighted foreign exchange value of the dollar against the major foreign currencies will move down slightly from its current level throughout the forecast period. This path is somewhat higher than in the January Greenbook, reflecting the dollar's recent appreciation. Against the yen, the dollar is expected to change little on balance as weakness in the Japanese economy and easy monetary conditions there counter downward pressures on the dollar stemming from widening current account imbalances in the United States and Japan. Against the euro, the dollar is projected to depreciate somewhat from its current level, reflecting similar pressures from current account imbalances.

Our forecast has the broad index of the real exchange value of the dollar rising slightly over the forecast period, on balance. The dollar's marginal real appreciation against the major currencies is explained by higher consumer price inflation in the United States than in foreign industrial countries. The dollar is expected to appreciate in real terms against all major Latin American currencies except the Brazilian *real*. We continue to project that Chinese authorities will begin to allow modest depreciation of the renminbi at some point during the forecast period, and we continue to assume that the Argentine and Hong Kong currency pegs will hold.

Activity in foreign industrial countries. Real GDP growth in foreign industrial countries is projected to run at about 2 percent this year and next, just a shade above the pace in the previous Greenbook. We have revised up our forecast for Canadian growth this year in view of recent signs of stronger activity as well as the more robust U.S. outlook. Canada is now expected to register growth near 3 percent this year and 2-1/2 percent in 2000.

Our outlook for the euro area, where we expect growth to be 2 percent this year with only a modest pickup in 2000, has not changed much since the January Greenbook. The euro-area output gap is expected to widen somewhat over the forecast period. We expect investment spending to be weak, but consumption should remain fairly robust. We continue to expect Japanese GDP to decline slightly this year and during the first half of 2000. Although our overall GDP forecast for 1999 has changed little, we now expect net exports to make a greater contribution (because of the recent depreciation of the yen) offset by a smaller contribution from public investment. The forecast for 2000 is a bit stronger than previously because of the improved outlook for Japanese net exports. We now see growth turning slightly positive in the second half of next year.

Inflation. Consumer price inflation in foreign industrial countries (weighted by U.S. non-oil import shares) is projected to fall to 1/2 percent this year and to edge up to about 3/4 percent in 2000. The recent depreciation of the yen takes a little off our projection of Japanese deflation in the near term. We now expect Japanese consumer prices to fall 1-3/4 percent in 1999 and to decline a further 1 percent in 2000.

Interest rates. Our assumption for Japanese short-term interest rates has been revised downward with the latest cut in the call money rate and indications that the Bank of Japan intends to maintain low interest rates until the economy revives. We have maintained the assumption that euro-area short-term interest rates decline 25 basis points in the second quarter of 1999, as the ECB cuts its key policy rates before midyear. Further declines in both official and market rates in the United Kingdom are expected in view of the slowdown in U.K. growth. Our outlook has long-term interest rates staying near their recent levels throughout 1999 and firming somewhat in 2000.

Other Countries. The outlook for growth in the major developing-country trading partners of the United States has improved. We now project that real GDP in the major developing countries will increase about 1/2 percent in 1999, compared with a projected decline of about 1/4 percent in the last Greenbook. In 2000, growth in the developing countries is expected to move up to nearly 3 percent, slightly stronger than in the January Greenbook.

Real GDP in Latin America is projected to decline in 1999 by considerably less than in our January forecast and to recover in 2000. Our projection for growth in Brazil has been strengthened slightly as Brazilian financial markets appear to have stabilized a bit sooner than we had assumed. Nevertheless, we still expect that high real interest rates and fiscal restraint will cause real GDP to decline more than 7 percent in 1999. However, the damage to other Latin American countries from Brazil's economic distress now appears less severe than previously feared. In particular, we project that growth in Mexico will be a positive 1-1/2 percent in 1999, compared with a 1 percent decline in the last Greenbook.

The developing Asian economies that experienced sharp declines in output last year are projected to bottom out in the first half of this year and return to positive if low growth by the end of the year. On average, real GDP growth in the Asian developing countries is expected to be a positive 1-1/4 percent in 1999, up slightly from the last Greenbook. In 2000, growth is expected to rise to about 3-1/4 percent.

Real exports and imports of goods and services. Real exports of goods and services in the fourth quarter of last year were slightly higher than we expected while real imports were lower than expected; real net exports contributed a positive 1/2 percentage point to GDP growth in the quarter. The surge in exports at the end of last year is expected to be partly reversed in the first quarter of this year, and imports continue to be boosted by strong consumption. The contribution to growth from the external sector is projected to be strongly negative in the current quarter.

Over the forecast period, the higher path for the U.S. dollar is expected to slow export growth from the pace we projected in January, although this downward adjustment is partly offset by the slightly stronger forecast for foreign growth. Total real exports of goods and services are expected to decline at an annual rate of 4 percent in the first half of 1999 but to recover thereafter, reaching a 4 percent growth rate in 2000. Core exports (excluding agricultural products, computers, and semiconductors) are expected to fall at an annual rate of 7 percent in the first half of this year and rise only modestly over the remainder of the forecast period.

The higher dollar and stronger outlook for U.S. economic activity led to an upward revision of our forecast for imports. Total real imports of goods and services are now expected to advance at an annual rate of about 9-1/4 percent in the first half of this year, and then grow at a somewhat slower pace for the rest of the forecast period. Oil imports should continue to rise at a steady pace throughout 1999 and 2000.

Oil prices. For the first quarter of 1999, the staff has slightly lowered the predicted price of imported oil to reflect weaker-than-expected prices in

February. Going forward, we have marked up the projected price of imported oil by an average of $0.60 per barrel over the last three quarters of 1999 and by $.30 per barrel in 2000, because of an agreement by major oil producers to reduce supply by 2 million barrels per day. The forecast assumes that only about half of these cuts will be implemented.

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

Trade category	1998		Projection		
			1999		2000
	H1	H2	H1	H2	
Exports					
Nonagricultural (core)	-2.1	-1.7	0.7	1.2	1.4
Agricultural	-11.0	-8.6	-2.0	1.6	2.0
Imports					
Non-oil (core)	-2.6	-1.5	0.2	0.7	1.0
Oil (level, dollars per barrel)	12.51	11.38	12.38	13.34	14.00

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.

Prices of non-oil imports and exports. After falling for the past three years, on balance, core import prices are projected to edge up in 1999 and then to increase 1 percent in 2000 as the effects of the dollar's appreciation wane. Commodity prices, which fell more than 13 percent last year and contributed importantly to lower import prices, declined in the current quarter but in future quarters are projected to rise at roughly the same rate as overall prices. The forecast turnaround in commodity prices relies on two factors. First, there was a robust supply response to high prices in recent years, which is now dissipating. Second, the foreign growth slowdown has reduced global demand for commodities, but total foreign GDP is expected pick up over the forecast period. However, the assumption of a stronger dollar has led us to lower the path of commodity prices from that projected in the January Greenbook. Core export prices are projected to rise about 1 percent in 1999 and 1-1/2 percent in 2000.

Nominal trade and current account balances. The nominal trade deficit for goods and services is projected to widen substantially during the forecast period, from about $170 billion in 1998 to about $300 billion in 2000. The deficit for net investment income is projected to widen nearly $50 billion between 1998 and 2000. As a result, the current account deficit is expected to expand from $234 billion last year (2-3/4 percent of GDP) to $410 billion for the year 2000 (4-1/2 percent of GDP and nearly 1 percentage point above the previous peak for this ratio reached in 1987).

Risks to the Foreign Outlook

The risks to the international outlook are more balanced than we had seen them at the time of the February FOMC meeting. The downside risks associated with developments in Brazil, while still a major concern, have eased somewhat as contagion to the rest of Latin America from setbacks to that country's economic program have been considerably less virulent than we had feared. Moreover, the road to recovery in Asia seems, if anything, a bit less rocky than we had envisioned previously. Some clouds on the economic horizon in Europe have partly dimmed this brighter view. Overall, we see the odds of a more vigorous recovery in global economic activity as now being more evenly balanced against those of a more prolonged and persistent downturn in key regions, resulting from, for example, a failure on the part of Brazil to follow through with its current reform program.

Recent developments in the world oil market may have increased the odds of either a positive or negative surprise on oil prices. On the upside, should OPEC and other oil producers hold the line on their agreed production cuts, oil prices could be as much as $4 per barrel higher than we have assumed. On the downside, because we believe that only part of the production cuts will be implemented, there is the distinct possibility that the agreement could break down entirely, leading to oil prices that are lower than we anticipate. If low-cost producers should cheat on the production cuts and strive to maintain their revenues with production increases, prices could fall by $5 per barrel relative to our forecast path. Simulations with our multi-country model indicate that a price decline of that magnitude would raise average U.S. GDP growth about 0.3 percentage points a year and reduce consumer price inflation about the same amount.

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

							-----Projected----		
Measure and country	1992	1993	1994	1995	1996	1997	1998	1999	2000
REAL GDP (1)									
Total foreign	2.1	3.4	5.1	2.0	4.1	4.1	0.5	1.3	2.4
Industrial Countries	0.6	1.8	4.0	1.7	2.6	3.3	1.6	2.0	2.0
of which:									
Canada	0.9	2.9	5.5	1.1	1.7	4.4	2.8	2.9	2.5
Japan	0.1	0.5	0.9	2.5	5.1	-0.8	-3.0	-0.6	-0.1
United Kingdom	0.7	3.2	4.6	1.9	2.6	4.0	1.0	1.4	2.3
Euro-11	0.1	-0.1	3.4	1.3	1.9	3.2	2.3	2.0	2.2
Germany	0.9	-0.2	3.4	0.1	2.1	2.3	1.8	1.8	2.3
Developing Countries	4.5	5.7	6.7	2.6	6.3	5.3	-1.0	0.5	2.9
Asia	6.7	8.6	8.4	6.7	7.0	5.1	-2.8	1.2	3.2
Korea	2.4	8.1	9.5	7.2	7.0	3.7	-5.3	2.5	3.8
China	14.6	13.2	12.0	10.1	9.4	7.9	9.2	5.2	6.2
Latin America	2.8	2.8	5.6	-4.1	6.4	6.3	0.9	-0.8	2.6
Mexico	2.5	1.9	5.1	-7.3	7.5	7.2	2.9	1.6	3.4
Brazil	0.1	4.4	9.6	-1.5	5.0	2.0	-1.9	-7.3	-1.0
CONSUMER PRICES (2)									
Industrial Countries	2.0	2.1	1.1	1.3	1.5	1.6	1.0	0.5	0.8
of which:									
Canada	1.8	1.8	-0.0	2.1	2.0	1.0	1.1	1.3	1.5
Japan	0.9	1.2	0.8	-0.8	0.1	2.1	0.7	-1.8	-1.1
United Kingdom (3)	3.7	2.7	2.2	2.9	3.2	2.8	2.6	2.4	2.5
Euro-11 (4)	NA	NA	NA	2.7	2.0	1.4	0.9	1.4	1.4
Germany	3.4	4.2	2.6	1.7	1.4	1.8	0.6	1.0	1.2
Developing Countries	21.7	24.8	23.1	17.0	11.2	6.9	8.9	6.7	7.7
Asia	5.5	7.7	10.7	6.4	4.8	2.8	4.6	0.8	4.4
Korea	4.7	5.5	5.8	4.4	5.1	5.1	6.0	1.5	2.6
China	8.2	17.1	26.9	11.1	7.0	1.0	-1.1	-5.2	3.6
Latin America	72.4	74.5	54.6	42.2	26.0	15.6	15.6	17.4	14.0
Mexico	13.2	8.6	6.9	48.8	28.1	17.2	17.6	17.7	14.2
Brazil	1150.1	2321.7	1237.1	22.5	10.5	4.2	2.7	19.1	12.7

1. Foreign GDP aggregates calculated using shares of U.S. non-agricultural exports.
2. Foreign CPI aggregates calculated using shares of U.S. non-oil imports.
3. CPI excluding mortgage interest payments, which is the targeted inflation rate.
4. Harmonized CPI's, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES
(Percent changes)

	1998				Projected 1999				Projected 2000			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	-0.6	0.4	0.9	1.3	0.8	1.1	1.5	1.9	1.9	2.3	2.6	2.6
Industrial Countries	1.8	1.1	1.5	2.1	1.9	2.0	1.9	2.1	1.6	2.0	2.2	2.2
of which:												
Canada	3.2	1.5	1.7	4.6	3.3	3.0	2.6	2.9	2.1	2.5	2.7	2.8
Japan	-4.8	-2.9	-1.2	-3.2	-1.2	-0.6	-0.3	-0.3	-0.8	-0.1	0.2	0.2
United Kingdom	1.4	1.3	1.0	0.4	0.4	1.5	1.6	2.1	1.8	2.2	2.6	2.6
Euro-11	3.1	2.4	2.8	0.9	1.8	1.9	2.1	2.3	1.8	2.3	2.4	2.4
Germany	5.3	-0.1	3.6	-1.5	1.1	1.6	2.2	2.5	1.8	2.4	2.5	2.5
Developing Countries	-3.9	-0.7	0.2	0.4	-0.6	-0.0	0.9	1.6	2.4	2.8	3.2	3.1
Asia	-10.3	-3.4	0.4	2.4	0.3	0.8	1.6	2.3	2.3	2.9	3.7	3.9
Korea	-22.1	-3.5	1.6	5.3	2.0	2.5	2.5	3.0	3.0	3.5	4.0	4.5
China	7.2	6.6	10.8	12.4	6.0	4.8	4.8	5.5	5.0	5.5	7.3	7.2
Latin America	3.6	2.5	0.1	-2.5	-2.2	-1.3	-0.2	0.5	2.6	2.7	2.8	2.3
Mexico	5.1	2.6	3.8	0.1	0.4	1.6	2.0	2.2	3.6	3.6	3.7	2.8
Brazil	0.0	5.4	-6.1	-6.4	-8.2	-10.0	-6.0	-5.0	-1.0	-1.0	-1.0	-1.0
CONSUMER PRICES (2)	Four-quarter changes											
Industrial Countries	1.5	1.1	0.8	1.0	0.7	0.7	0.6	0.5	0.6	0.7	0.8	0.8
of which:												
Canada	1.0	1.0	0.9	1.1	0.9	1.2	1.3	1.3	1.4	1.4	1.5	1.5
Japan	2.1	0.6	-0.1	0.7	-0.2	-0.9	-1.5	-1.8	-1.7	-1.6	-1.4	-1.1
United Kingdom (3)	2.5	3.0	2.6	2.6	2.5	2.4	2.4	2.4	2.5	2.4	2.5	2.5
Euro-11 (4)	1.2	1.4	1.2	0.9	1.1	1.2	1.3	1.4	1.4	1.4	1.4	1.4
Germany	1.2	1.3	0.8	0.6	0.3	0.7	0.9	1.0	1.2	1.2	1.2	1.2
Developing Countries	7.4	7.6	8.0	8.9	7.4	7.1	7.1	6.7	7.6	7.9	7.8	7.7
Asia	4.2	4.7	4.6	4.6	1.8	1.0	0.7	0.8	2.7	3.6	4.0	4.4
Korea	8.9	8.2	7.0	6.0	0.7	0.8	1.4	1.5	2.1	2.3	2.5	2.6
China	0.4	-0.9	-1.4	-1.1	-4.3	-4.5	-4.6	-5.2	-0.9	1.5	2.4	3.6
Latin America	14.1	14.2	14.3	15.6	16.5	17.2	18.1	17.4	15.7	15.2	14.6	14.0
Mexico	15.3	15.1	15.6	17.6	18.7	19.3	19.3	17.7	15.4	15.0	14.7	14.2
Brazil	4.4	4.5	3.6	2.7	3.0	6.9	14.2	19.1	20.2	17.6	13.8	12.7

1. Foreign GDP aggregates calculated using shares of U.S. non-agricultural exports.
2. Foreign CPI aggregates calculated using shares of U.S. non-oil imports.
3. CPI excluding mortgage interest payments, which is the targeted inflation rate.
4. Harmonized CPI's, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1992	1993	1994	1995	1996	1997	--------Projected------ 1998	1999	2000
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	-0.4	-0.6	-0.4	0.5	-0.3	-0.6	-1.1	-1.1	-0.5
Exports of G&S	0.4	0.5	1.0	1.1	1.2	1.1	0.1	-0.1	0.4
Imports of G&S	-0.8	-1.1	-1.4	-0.7	-1.4	-1.7	-1.2	-1.1	-0.9
	Percentage change, Q4/Q4								
Exports of G&S	4.1	4.6	10.0	10.5	10.3	9.6	0.9	-0.5	4.0
Services	-0.9	4.1	6.0	9.8	7.5	1.5	-0.6	-0.2	1.8
Agricultural Goods	10.4	-5.5	16.6	-4.3	4.8	2.8	-1.1	-11.6	0.2
Computers	25.2	23.7	32.0	55.5	35.9	40.7	6.5	23.3	28.1
Semiconductors	64.8	32.9	66.9	79.6	46.2	21.0	9.2	22.1	23.6
Other Goods 1/	2.3	3.6	7.0	5.8	8.0	11.6	1.0	-3.0	1.9
Imports of G&S	7.4	10.2	12.3	5.6	11.8	14.0	9.7	8.4	6.9
Services	1.4	3.2	1.4	6.1	5.5	12.4	2.5	4.3	3.2
Oil	12.1	10.1	-0.2	2.4	7.9	4.0	6.0	5.5	6.1
Computers	45.1	39.3	44.8	48.1	24.4	30.3	28.2	29.6	28.4
Semiconductors	42.0	34.2	54.5	92.4	57.6	32.7	-7.7	26.5	27.4
Other Goods 2/	5.4	9.5	12.2	-1.1	10.4	13.0	10.9	7.1	5.2
	Billions of chained 1992 dollars								
Net Goods & Services	-29.5	-70.2	-104.6	-96.5	-111.2	-136.1	-238.5	-334.8	-402.5
Exports of G&S	639.4	658.2	712.4	792.6	860.0	970.0	984.4	993.0	1021.2
Imports of G&S	669.0	728.4	817.0	889.0	971.2	1106.1	1222.9	1327.8	1423.7
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-51.4	-86.1	-123.8	-115.3	-134.9	-155.2	-233.6	-338.5	-410.5
Net Goods & Services (BOP)	-38.7	-71.9	-100.9	-99.9	-108.6	-110.2	-169.3	-244.9	-299.5
Exports of G&S (BOP)	617.3	643.2	703.8	795.6	850.8	937.6	931.0	930.2	961.0
Imports of G&S (BOP)	656.0	715.2	804.7	895.5	959.3	1047.8	1100.3	1175.1	1260.5
Net Investment Income	22.5	23.9	16.5	19.3	14.2	-5.3	-22.5	-50.9	-68.2
Direct, Net	51.6	55.7	51.8	63.0	66.2	63.7	54.6	37.7	37.7
Portfolio, Net	-29.1	-31.7	-35.3	-43.7	-51.9	-69.1	-77.1	-88.6	-105.9
Net Transfers	-35.2	-38.1	-39.4	-34.6	-40.6	-39.7	-41.9	-42.8	-42.8

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1995				1996				1997			
	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	-0.2	-0.3	1.6	0.7	-1.1	-1.0	-1.4	2.4	-1.3	-0.4	-0.5	-0.3
Exports of G&S	1.0	0.6	1.9	1.1	0.4	0.6	0.2	3.2	0.9	1.7	1.2	0.5
Imports of G&S	-1.2	-0.9	-0.3	-0.4	-1.5	-1.6	-1.6	-0.9	-2.2	-2.2	-1.7	-0.8
Percentage change from previous period, SAAR												
Exports of G&S	9.2	5.4	17.8	10.2	3.7	5.8	2.1	32.0	8.3	15.5	10.6	4.4
Services	9.1	2.9	21.7	6.4	-4.0	10.3	-9.9	39.8	-6.7	11.8	5.9	-4.0
Agricultural Goods	1.8	-13.4	5.0	-9.4	22.6	-32.8	-1.6	48.7	-16.1	-7.8	8.7	32.8
Computers	36.4	33.8	86.6	71.6	57.6	24.7	27.7	35.9	70.2	78.7	41.9	-9.2
Semiconductors	72.0	100.8	96.2	53.6	23.8	29.7	30.2	118.6	41.3	17.3	32.3	-2.2
Other Goods 1/	4.3	1.4	9.4	8.1	0.1	6.0	5.7	21.3	13.8	15.6	9.2	8.0
Imports of G&S	9.8	7.2	2.0	3.5	13.1	13.5	13.6	7.0	18.6	17.9	13.5	6.3
Services	20.5	-3.3	3.1	5.5	9.2	4.3	9.9	-1.1	17.8	10.6	15.8	5.8
Oil	-11.4	15.4	31.4	-18.2	-9.8	68.9	3.5	-14.0	-8.2	37.0	6.0	-12.2
Computers	15.4	51.6	62.7	69.3	22.5	22.9	18.8	33.8	54.5	39.0	30.6	2.9
Semiconductors	37.1	105.5	128.2	113.3	38.7	8.9	50.1	172.1	89.0	16.0	20.3	17.6
Other Goods 2/	7.2	1.5	-8.8	-3.8	13.9	10.5	13.4	4.1	16.2	16.1	11.8	8.1
Billions of chained 1992 dollars, SAAR												
Net Goods & Services	-109.5	-114.7	-86.8	-74.8	-95.5	-113.5	-140.1	-95.9	-121.5	-131.6	-142.4	-149.0
Exports of G&S	763.9	774.0	806.3	826.1	833.6	845.5	849.9	911.1	929.4	963.6	988.1	998.8
Imports of G&S	873.4	888.7	893.1	900.9	929.1	958.9	990.0	1007.0	1050.9	1095.2	1130.5	1147.8
Billions of dollars, SAAR												
US CURRENT ACCOUNT BALANCE	-123.7	-134.2	-115.5	-87.7	-112.9	-132.0	-161.6	-133.2	-148.0	-140.4	-152.4	-180.2
Net Goods & Services (BOP)	-109.3	-125.8	-90.0	-74.5	-92.4	-112.8	-132.3	-96.8	-112.5	-106.1	-108.4	-113.8
Exports of G&S (BOP)	765.4	782.0	809.7	825.6	833.6	845.3	837.5	886.7	904.7	936.1	951.7	957.8
Imports of G&S (BOP)	874.7	907.7	899.7	900.1	926.0	958.2	969.8	983.5	1017.3	1042.1	1060.1	1071.7
Net Investment Income	20.1	24.0	10.2	22.7	21.4	15.9	6.9	12.7	0.1	1.8	-6.2	-17.0
Direct, Net	59.9	67.2	56.5	68.3	64.8	64.4	61.9	73.6	64.2	69.6	65.5	55.6
Portfolio, Net	-39.8	-43.2	-46.2	-45.5	-43.3	-48.5	-55.0	-60.9	-64.2	-67.8	-71.7	-72.6
Net Transfers	-34.5	-32.4	-35.8	-35.9	-41.9	-35.1	-36.2	-49.1	-35.5	-36.1	-37.8	-49.3

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

Strictly Co ential (FR) March 1999
Class II F(

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1998 Q1	1998 Q2	1998 Q3	1998 Q4	Projected 1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-2.3	-2.1	-0.6	0.5	-2.0	-1.3	-0.9	-0.4	-0.7	-0.7	-0.6	-0.0
Exports of G&S	-0.3	-0.9	-0.3	2.0	-0.9	-0.0	0.2	0.5	0.0	0.4	0.5	0.7
Imports of G&S	-1.9	-1.2	-0.3	-1.5	-1.1	-1.3	-1.1	-0.9	-0.7	-1.1	-1.1	-0.8
Percentage change from previous period, SAAR												
Exports of G&S	-2.8	-7.7	-2.8	19.0	-7.6	-0.1	1.7	4.3	0.3	3.8	4.8	7.2
Services	-1.2	1.7	-10.4	8.3	0.1	-1.0	-0.5	0.6	1.1	2.0	1.8	2.1
Agricultural Goods	-9.9	-23.4	-14.5	61.9	-35.2	-16.9	11.3	1.8	-6.8	-2.7	8.3	2.6
Computers	-15.5	8.7	20.6	16.1	14.7	26.2	26.2	26.2	27.2	28.1	28.6	28.6
Semiconductors	-2.0	-19.7	29.7	39.2	23.9	21.6	21.6	21.6	22.7	23.9	23.9	23.9
Other Goods 1/	-1.6	-11.0	-1.2	20.4	-11.9	-1.6	-1.4	3.5	-3.4	1.8	2.6	7.0
Imports of G&S	15.7	9.3	2.3	12.0	8.6	10.0	8.5	6.5	5.6	8.3	8.0	5.8
Services	9.3	-0.6	-0.6	2.5	2.7	5.3	4.8	4.4	1.0	5.0	3.3	3.4
Oil	8.8	41.4	-5.7	-13.1	2.2	34.0	10.3	-17.9	6.5	25.7	11.4	-15.1
Computers	38.8	22.4	9.8	45.1	32.3	31.1	28.7	26.3	26.3	28.7	29.1	29.6
Semiconductors	9.9	-28.8	-10.5	3.4	27.4	26.2	26.2	26.2	26.7	27.2	27.7	28.2
Other Goods 2/	16.1	10.8	3.5	13.8	7.6	7.5	6.8	6.5	4.0	5.5	6.2	5.1
Billions of chained 1992 dollars, SAAR												
Net Goods & Services	-198.5	-245.2	-259.0	-251.4	-297.1	-328.4	-351.4	-362.3	-380.3	-398.8	-414.2	-416.8
Exports of G&S	991.9	972.1	965.3	1008.2	988.6	988.3	992.4	1002.9	1003.6	1013.0	1025.1	1043.0
Imports of G&S	1190.4	1217.3	1224.3	1259.6	1285.7	1316.7	1343.8	1365.2	1383.9	1411.8	1439.3	1459.8
Billions of dollars, SAAR												
US CURRENT ACCOUNT BALANCE	-188.1	-227.9	-262.8	-255.7	-291.3	-328.6	-353.7	-380.6	-388.1	-405.3	-417.9	-430.5
Net Goods & Services (BOP)	-141.5	-176.9	-186.0	-172.7	-209.0	-241.5	-260.1	-269.0	-284.2	-298.5	-308.4	-307.0
Exports of G&S (BOP)	944.8	921.0	909.4	948.9	924.7	925.4	930.2	940.7	942.3	952.6	965.3	983.7
Imports of G&S (BOP)	1086.3	1097.9	1095.4	1121.6	1133.7	1166.8	1190.2	1209.7	1226.5	1251.0	1273.8	1290.7
Net Investment Income	-8.9	-13.4	-36.7	-31.0	-42.3	-47.1	-53.6	-60.6	-63.9	-66.9	-69.4	-72.6
Direct, Net	62.5	60.9	44.5	50.7	40.9	39.1	37.0	33.9	34.8	36.2	38.8	41.0
Portfolio, Net	-71.4	-74.2	-81.1	-81.8	-83.2	-86.2	-90.6	-94.5	-98.7	-103.1	-108.2	-113.5
Net Transfers	-37.7	-37.6	-40.1	-52.0	-40.0	-40.0	-40.0	-51.0	-40.0	-40.0	-40.0	-51.0

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

Internal FR

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF RESEARCH AND STATISTICS

Date: March 25, 1999

To: Federal Open Market Committee

From: Mike Prell

Subject: Greenbook Part 1 Correction

Strictly Confidential (FR) -- Class II FOMC

The last sentence on page I-2 should have ended "...while the market price-earnings multiple, measured on trailing earnings, will *remain around its current level.*" The current text mentions a further rise in the P-E ratio. Our projection does indeed show a moderate decline in economic profits from the current level, but it probably doesn't imply much change in the 12-month moving average of earnings used to calculate conventional market PEs.